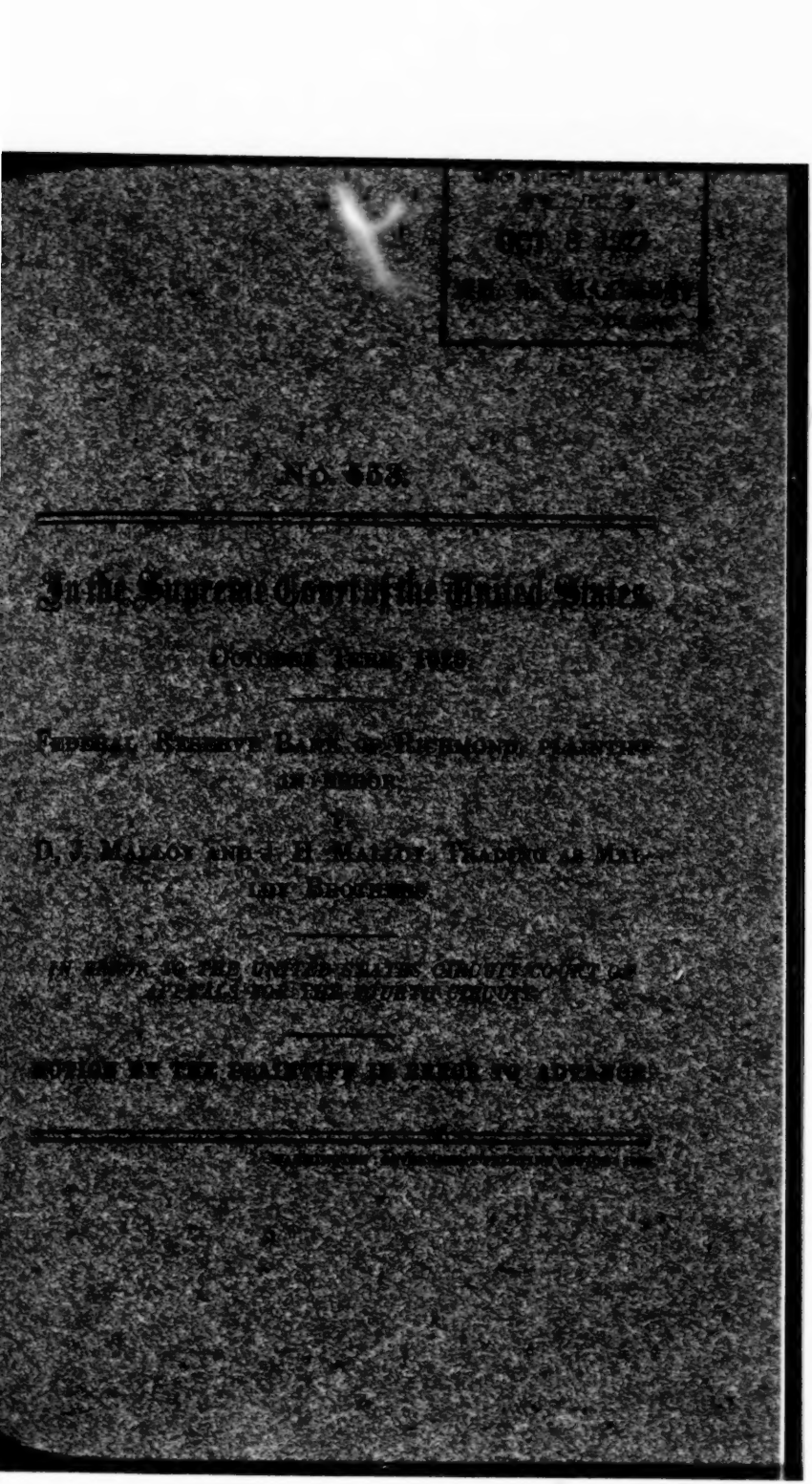

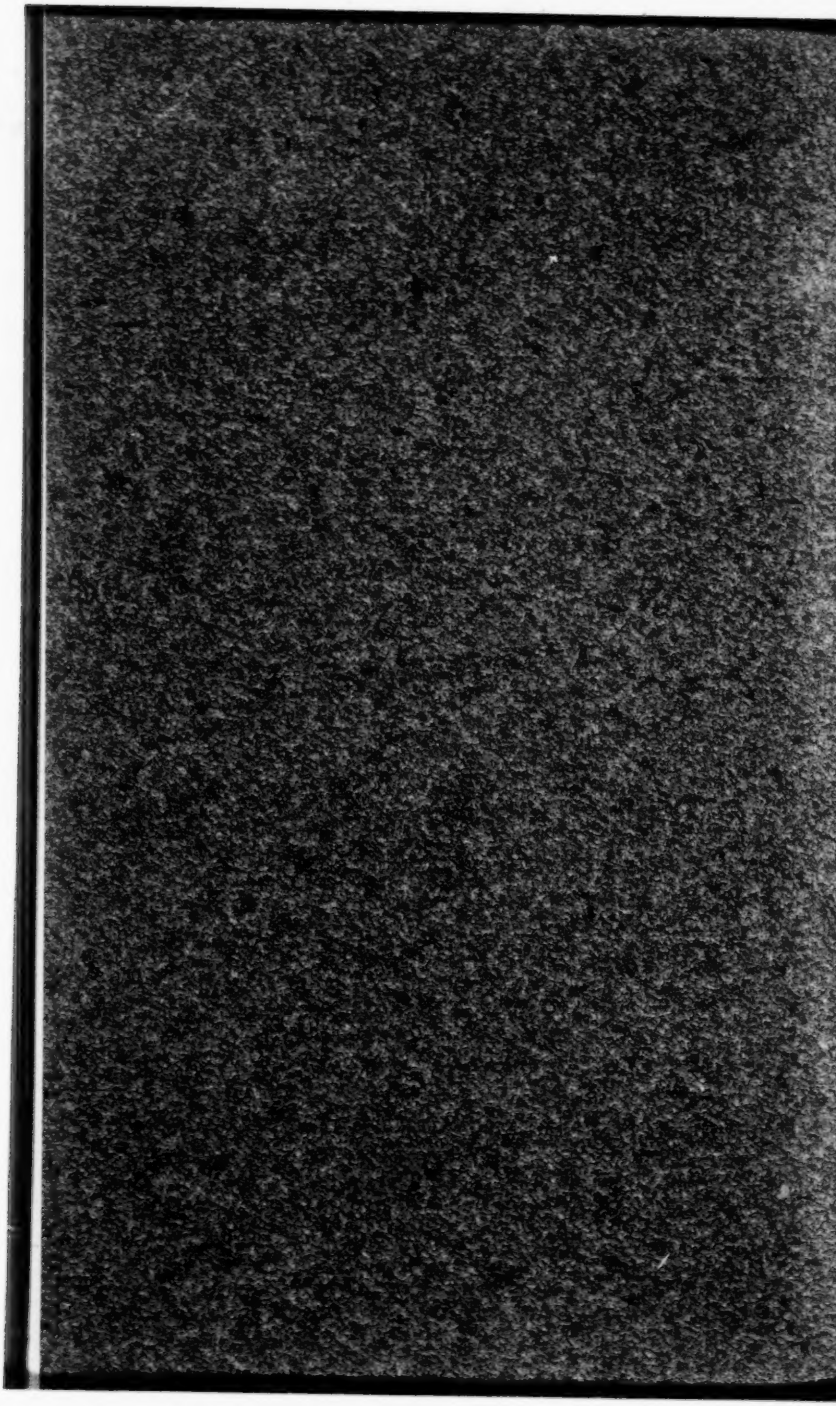

In the Supreme Court of the United States

OCTOBER TERM, 1923.

FEDERAL RESERVE BANK OF RICHMOND, plaintiff in error,
v.
D. J. MALLOY AND J. H. MALLOY, TRADING as Malloy Brothers.
No. 553.

IN ERROR TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

MOTION BY THE PLAINTIFF IN ERROR TO ADVANCE.

To the Honorable Chief Justice and the Associate Justices of the Supreme Court of the United States:

The petition of the Federal Reserve Bank of Richmond respectfully shows as follows:

1. This case is pending in this court on a writ of error to review a judgment of the United States Circuit Court of Appeals for the Fourth Circuit affirming a judgment of the District Court of the United States for the Eastern District of North Carolina.

2. A statement of the facts in the case can be found in the opinion of the District Judge (printed transcript of the record, page 15). So far as perti-

nent to the purpose of this petition, the essential facts may be stated as follows:

The Federal Reserve Bank of Richmond received for collection from the Citizens & Southern Bank of Atlanta, Georgia, a check for $9,000.00, drawn upon the Bank of Lumber Bridge, North Carolina, a nonmember State bank. This check was drawn by Napier H. G. Balfour to the order of Malloy Bros. and indorsed by Malloy Bros., Perry Banking Company, Atlantic National Bank of Jacksonville, Florida; and the Citizens & Southern Bank of Atlanta, Georgia. The Federal Reserve Bank of Richmond sent the check to the Bank of Lumber Bridge for remittance in ordinary course. The Bank of Lumber Bridge canceled the check, charged it to the account of Balfour, and sent to the Federal Reserve Bank of Richmond a bank draft payable in Greensboro, North Carolina. The Federal Reserve Bank of Richmond sent this exchange draft to Greensboro for payment, but it was dishonored; and before the Federal Reserve Bank of Richmond could collect the amount from the Bank of Lumber Bridge that bank was placed in the hands of a receiver.

3. The Citizens & Southern Bank of Atlanta was a member of the Federal Reserve System, and the Federal Reserve Board had promulgated a certain regulation reading in part as follows:

> In handling items for member and nonmember clearing banks, a Federal Reserve Bank will act as agent only. The Board will require that each member and nonmember clearing

> bank authorize its Federal Reserve Bank to send checks for collections to banks on which checks are drawn, and except for negligence, such Federal Reserve Banks will assume no liability.

Malloy Bros. contended that the Federal Reserve Bank of Richmond was their agent and that the check was an unconditional order for money and that the Federal Reserve Bank of Richmond was negligent in accepting from the Bank of Lumber Bridge any medium of payment except lawful money. This contention the courts below sustained.

4. In the case of *American Bank & Trust Company* v. *Federal Reserve Bank of Atlanta* (opinion delivered June 11, 1923), this court held that a Federal reserve bank was authorized to receive checks for collection on nonmember state banks and to present them through the mails or otherwise for payment in money or by a bank draft. The contention was made in that case that an unconditional demand for money and a refusal to accept settlement in exchange draft would amount to coercion. The court did not decide this point, as the Federal Reserve Bank of Atlanta had alleged that it intended to accept exchange drafts. In the instant case, the courts below held that a Federal reserve bank must insist on payment in currency and should not accept settlement by means of exchange drafts.

Since the Federal reserve banks are now collecting checks upon the majority of the nonmember banks of this country, we assert that it is of the greatest

importance to the Federal reserve banks and the persons whose checks are collected through them to know whether or not a Federal reserve bank may accept exchange drafts or must, at its peril, demand payment in money in settlement for all checks drawn upon nonmember State banks.

Wherefore, your petitioner respectfully prays that this Honorable Court will grant the motion to advance this case on the calendar of this Honorable Court.

We are authorized by counsel representing the defendants in error to say that he has no objection to this case being advanced upon the docket.

Respectfully submitted.

JAMES M. BECK,
Solicitor General.

M. G. WALLACE,
Solicitor and Counsel for the Plaintiff in Error.

OCTOBER, 1923.

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WM. R. STA

Supreme Court of the United States

OCTOBER TERM, 1923.

No. 553.

FEDERAL RESERVE BANK OF RICHMOND, PLAINTIFF IN ERROR,

versus

D. J. MALLOY & J. H. MALLOY, TRADING AS MALLOY BROTHERS, DEFENDANTS IN ERROR.

IN ERROR TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

M. G. WALLACE,
Counsel for Plaintiff in Error.

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Supreme Court of the United States

FEDERAL RESERVE BANK OF RICHMOND, PLAINTIFF IN ERROR,

versus

D. J. MALLOY & J. H. MALLOY, PARTNERS, TRADING AS MALLOY BROTHERS, DEFENDANTS IN ERROR.

BRIEF FOR FEDERAL RESERVE BANK OF RICHMOND, PLAINTIFF IN ERROR.

HISTORY OF PROCEEDINGS.

This is a civil action originally instituted in the Superior Court for Cumberland County, North Carolina, by Malloy Brothers, defendants in error, against the Federal Reserve Bank of Richmond, plaintiff in error, and N. H. G. Balfour, to recover the sum of nine thousand dollars ($9,000.00), that being the amount of a check drawn by Balfour to the order of Malloy Brothers, upon the Bank of Lumber Bridge, which the Federal Reserve Bank had received for collection and sent to the drawee bank for remittance, and for which the drawee bank had sent in settlement a worthless draft. The plaintiff in error was organized under the laws of the United States,

and in due time it filed a petition praying that the case be removed to the District Court of the United States for the Eastern District of North Carolina, upon the ground of the Federal incorporation of the defendant. This was accordingly done. The Federal Reserve Bank of Richmond and N. H. G. Balfour both filed answers in the Federal court, denying liability, and the case came on for trial.

By stipulation in writing (Transcript, page 14) a trial by jury was waived. There was no substantial conflict in the evidence, and the plaintiffs and both defendants moved the trial court to give judgment as a matter of law on the uncontradicted evidence. The court filed a written statement of facts and opinion, and gave judgment in favor of Balfour, but against the Federal Reserve Bank of Richmond. No exception was taken to so much of the judgment as discharged Balfour, but the Federal Reserve Bank of Richmond filed bills of exception embodying the entire testimony and made three assignments of error, which, in substance, presented only one contention, i. e., that upon the facts of the case, as shown by the uncontradicted evidence and as stated by the court, the plaintiffs were not entitled to judgment. The judgment of the trial court was reviewed on writ of error by the Circuit Court of Appeals for the Fourth Judicial Circuit, which adopted in substance the opinion filed by the judge of the District Court, and affirmed the judgment. The Federal Reserve Bank of Richmond, plaintiff in error, thereupon filed in the Circuit Court of Appeals assignments of error, substantially the same as those relied upon in the District Court, and sued out a writ of error to this court.

STATEMENT OF FACTS.

The essential facts may be stated as follows:

Balfour was indebted to Malloy Brothers upon a note secured by a mortgage, and sent to them a check

payable to their order for the sum of nine thousand dollars ($9,000.00), drawn upon the Bank of Lumber Bridge, North Carolina. This check was received by Malloy Brothers at their office at Quitman, Georgia, and a memorandum of credit was endorsed on the note of Balfour, but the note and mortgage were not surrendered or cancelled. (Testimony of J. H. Malloy, Transcript, page 33.) Malloy Brothers endorsed the check and deposited it for collection with the Perry Banking Company, of Perry, Florida (Transcript, page 33). The check was endorsed in blank, but the agreement under which it was deposited appears in the record (Transcript, page 33). The Perry Banking Company endorsed the check and sent it to the Atlantic National Bank of Jacksonville. The record does not show the terms upon which the Atlantic National Bank accepted the check. The Citizens & Southern Bank received the check at its office in Atlanta, Georgia, from the Atlantic National Bank of Jacksonville, Florida, for collection for the credit of the Jacksonville bank. The terms and conditions upon which the check was received by the Citizens & Southern Bank are shown in the record (Testimony of J. A. Wallace, Transcript, page 41). The Citizens & Southern Bank was a member of the Federal Reserve System and did business in the Sixth, or Atlanta, District, and it had made an arrangement with the Federal Reserve Bank of Atlanta and Richmond whereby checks payable in North Carolina would be collected for the Citizens & Southern Bank and credited to its account with the Federal Reserve Bank of Atlanta. The arrangement between the member bank and the two Federal Reserve Banks will be stated at greater length hereafter. The Bank of Lumber Bridge, upon which the check was drawn, was not a member of the Federal Reserve System, but had agreed with the Federal Reserve Bank of Richmond to remit at par for checks sent to it through the mails. The agreement was that remittance might be either by shipment of currency at the expense of the Federal Reserve Bank of

Richmond, or by draft drawn by the Bank of Lumber Bridge upon some reserve correspondent. (Transcript, pp. 59 and 60.)

The check was received by the Federal Reserve Bank of Richmond on December 10, 1920, and was on that date sent to the Bank of Lumber Bridge for remittance, in pursuance of the above stated agreement (Transcript, page 52). The Bank of Lumber Bridge cancelled the Balfour check, charged it to the account of Balfour, and sent to the Federal Reserve Bank of Richmond, in settlement for this and other checks, a draft drawn by the Bank of Lumber Bridge on its reserve correspondent, the Atlantic Banking & Trust Company of Greensboro, North Carolina. This remittance draft was received by the Federal Reserve Bank of Richmond on December 15th, and on that day sent to Greensboro for payment. On December 17th, the Atlantic Banking & Trust Company wired that the draft was not good and would not be paid (Transcript, page 53). The Federal Reserve Bank of Richmond called on the Bank of Lumber Bridge to make the draft good and sent a special representative to Lumber Bridge to attempt to collect the amount, but the Bank of Lumber Bridge did not have and could not obtain a sufficient sum in cash to pay the amount due (Testimony of D. M. Hale, Transcript, page 60). On December 24th, the Bank of Lumber Bridge was closed by the order of the State Bank Examiner.

The Federal Reserve Bank of Richmond had notified the Federal Reserve Bank of Atlanta and the Citizens & Southern Bank that the remittance draft issued by the Bank of Lumber Bridge had been dishonored (Transcript, page 55), and, accordingly, the Federal Reserve Bank of Richmond refused to give final credit for the amount of the Balfour check.

The defendants in error, plaintiffs below, in substance alleged in their complaint (Transcript, pages 2 and 4):

1. That the Federal Reserve Bank of Richmond was their agent.

2. That it had negligently failed to collect the check drawn by Balfour in that:

(a) It had sent the check to the bank upon which it was drawn;

(b) It had accepted an exchange draft in settlement, instead of insisting upon payment in cash; and

(c) It had failed to promptly and correctly notify Malloy Brothers of the situation which arose after the exchange draft was dishonored.

The Citizens & Southern Bank was a member of the Federal Reserve System and did business in the district of the Federal Reserve Bank of Atlanta. It could not have an account with the Federal Reserve Bank of Richmond, but the regulations of the Federal Reserve Board (See Federal Reserve Regulation J, paragraph 2, Transcript, page 37) provided that checks might be sent by a member bank in one district to a Federal Reserve Bank in another district, to be collected for the account of the Federal Reserve Bank in the member bank's own district, just as if the checks had been sent by the member bank to its own Federal Reserve Bank, and by that bank sent to the Federal Reserve Bank in the district in which the checks were payable. This arrangement could be made only with the approval of the Federal Reserve Bank in the district in which the member bank was situated (Testimony of J. A. Wallace, Transcript, page 44; Testimony of M. W. Bell, Transcript, page 49). In pursuance of this regulation, the Federal Reserve Bank of Atlanta had authorized the Citizens & Southern Bank to send checks directly to the Federal Reserve Bank of Richmond for the credit of the Federal Reserve Bank of

Atlanta, but such checks were handled just as if sent to the Federal Reserve Bank of Richmond by the Federal Reserve Bank of Atlanta, the Richmond bank acting merely as a deputy or agent of the Atlanta bank.

Regulation J also prescribed the terms and conditions upon which checks could be received by Federal Reserve Banks for collection. This regulation is printed at length in the record (Transcript, page 39). The Federal Reserve Bank of Atlanta had, by a circular letter, notified the Citizens & Southern Bank that it could receive checks for collection only upon certain terms and conditions. The circular letter of the Federal Reserve Bank of Atlanta set out the substance of the regulation, and the Citizens & Southern Bank had agreed to be bound by the terms set forth in the circular (Transcript, page 47). The pertinent part of Regulation J is as follows:

> "In handling items for member and non-member clearing banks, a Federal Reserve Bank will act as agent only. The Board will require that each member and non-member clearing bank authorize its Federal Reserve Bank to send checks for collection to banks on which checks are drawn, and except for negligence, such Federal Reserve Banks will assume no liability. Any further requirements that the Board may deem necessary will be set forth by the Federal Reserve Banks in their letters of instruction to their member and non-member clearing banks. Each Federal Reserve Bank will also promulgate rules and regulations governing the details of its operations as a clearing house, such rules and regulations to be binding upon all member and non-member banks which are clearing through the Federal Reserve Bank."

The Federal Reserve Bank of Richmond, therefore, contended:

1. That it had received the check from the Citizens & Southern Bank for the credit of the Federal Reserve

Bank of Atlanta and that there was no privity of contract between itself and Malloy Brothers, so that it was not their agent but was acting solely for the Federal Reserve Bank of Atlanta and the Citizens & Southern Bank of Atlanta.

2. That even if the Federal Reserve Bank of Atlanta was regarded as the agent of Malloy Brothers, it had fully discharged its duties, because:

(a) The Citizens & Southern Bank had expressly agreed that the check might be sent for collection directly to the bank on which it was drawn;

(b) Bank drafts were the usual method of remittance, so that authority to send the check for collection directly to the bank on which it was drawn implied authority to accept a remittance draft; and the acceptance of the draft did not increase the risk necessarily incident to sending a check for collection directly to the bank on which it was drawn.

(c) The Federal Reserve Bank of Richmond had handled the check promptly and correctly and had promptly and correctly notified the Citizens & Southern Bank of the situation as soon as it was apparent that the Bank of Lumber Bridge could not make its remittance draft good and that an earlier notice would have been of no avail.

The court, in its opinion, set out the facts above stated and held that the surrender and cancellation of the check released Balfour; and upon the subject of the liability of the Federal Reserve Bank of Richmond held:

1. That the Citizens & Southern Bank was an agent of Malloy Brothers, so that they were privy to the contract between the Citizens & Southern Bank and the Federal Reserve Banks.

2. That the regulation of the Federal Reserve Board entered into the contract between the member bank and the Federal Reserve Banks and contained the exclusive statement of the liability of the Federal Reserve Bank.

3. That the Federal Reserve Bank of Richmond had promptly and diligently handled the check and the remittance draft and had, therefore, strictly speaking, committed no negligence.

4. But that the Balfour check was an order for money and the Federal Reserve Bank was not authorized to waive the requirement of common law that checks should be paid in lawful money and that, therefore, the Federal Reserve Bank was liable for accepting an exchange draft upon the Bank of Lumber Bridge.

The three assignments of error made by the Federal Reserve Bank presented in substance the following points:

1. That upon the uncontradicted evidence judgment should have been given in its favor.

2. That the court erred in the effect it gave to certain testimony concerning the use of bank drafts by banks.

3. That the facts, as found and stated by the court, showed that judgment should have been in favor of the Federal Reserve Bank of Richmond.

However, as we have stated above, these three assignments present only one proposition, i. e., that as a matter of law upon the uncontradicted evidence the plaintiff below was not entitled to recover.

ARGUMENT ON FIRST ASSIGNMENT OF ERROR.

The first assignment of error in this court is substantially the same as the first assignment of error in the Circuit Court of Appeals (Transcript, pages 72 and 85), it is:

> "The Circuit Court of Appeals erred in affirming the judgment entered by the District Court of the United States for the Eastern District of North Carolina, and in not reversing said judgment, for that it appeared from the uncontradicted evidence in the said case that the Federal Reserve Bank of Richmond, plaintiff in error, was in no way liable to the defendant in error, and the said District Court was moved to so find and rule, but the said District Court refused to so find and rule, and gave judgment against the plaintiff in error."

In the discussion of this assignment of error two questions of law arise:

1. Can Malloy Brothers maintain an action against the Federal Reserve Bank of Richmond upon the theory that it was their agent?

2. If the Federal Reserve Bank of Richmond be regarded as agent of Malloy Brothers, has it been in any way negligent?

THERE WAS NO PRIVITY OF CONTRACT BETWEEN THE PARTIES.

Malloy Brothers and the Federal Reserve Bank of Richmond Were Strangers in Fact.

Malloy Brothers, in their complaint, allege that the Federal Reserve Bank of Richmond was their agent; but agency is a contractual relation which arises only by

mercial law, it is one upon which the Federal courts do not, of necessity, follow the state decisions.

There Could Have Been no Contractual Relation Between Malloy Brothers and the Federal Reserve Bank of Richmond.

Federal Reserve Banks can receive checks on deposit or for collection only for the account of member banks, non-member banks which have opened clearing accounts, other Federal Reserve Banks, and the United States and certain other public agencies, such as the War Finance Corporation. Therefore, the Federal Reserve Bank of Richmond could not have made an agreement binding it to act as the agent of Malloy Brothers and to be accountable to them, as such an agreement would have been *ultra vires* and void, and no action would lie upon it. We, therefore, respectfully submit that the Federal Reserve Bank of Richmond could not in law, and did not in fact, contract with Malloy Brothers. Hence, no action can be maintained against it by them. The Federal Reserve Bank of Richmond is answerable for its actions to the Federal Reserve Bank of Atlanta and the Citizens & Southern Bank with which it contracted, and to no other person. Malloy Brothers may maintain an action against the Perry Banking Company, which is their agent, and against no other person.

THE FEDERAL RESERVE BANK OF RICHMOND ACCEPTED THE CHECK FOR COLLECTION UPON CONDITION THAT IT WOULD BE SENT TO THE DRAWEE FOR REMITTANCE IN THE USUAL WAY.

If the court be of the opinion that Malloy Brothers can maintain this action at all, we think that it is undeniable that they can do so only upon the theory adopted by the trial court, i. e., that the Citizens & Southern Bank

is their agent and they were, therefore, privy to the contract made between the Citizens & Southern Bank and the Federal Reserve Bank of Atlanta, to which contract the Federal Reserve Bank of Richmond was likewise privy. But since the Citizens & Southern Bank was the holder of a check endorsed in blank, and Malloy Brothers' real interest, if it existed, was unknown, if they sue upon the contract made by the Citizens & Southern Bank they ratify it in all things and stand exactly in the shoes of their agent.

This contract was made in Georgia and was between two Federal Reserve Banks and a member bank. If a Federal law or regulation was applicable, it would control. If no Federal law was applicable, the contract must be regarded as one made in Georgia to be performed in North Carolina.

The learned judge below held, and, we think, correctly, that Regulation J established a complete rule for determining the rights of the parties, for he says, "This regulation, to the extent of its permissive provisions, must be taken to have been known to the Citizens & Southern Bank of Atlanta and the Federal Reserve Bank of Atlanta." (Transcript, page 47.)

The regulations of the Federal Reserve Board were intended to govern the operation of Federal Reserve Banks in establishing a method for the collection of checks in every state in the Union. In order to properly understand them, we must take into consideration the methods and practices in common use among bankers and the law relating to the duties and obligations of a collecting bank.

If a bank in one town receives on deposit or for collection a check payable in another town, there are three possible ways by which it may be collected:

1. The collecting bank may dispatch a special messenger to the place where the check is payable and for-

agreement between the parties. Malloy Brothers did not know that the check had been deposited in the Federal Reserve Bank of Richmond, for J. H. Malloy testified (Transcript, page 33): "I do not know of my own knowledge what happened to the check after it was deposited by us with the Perry Banking Company." The check was endorsed in blank (Transcript, page 33). Although the Perry Banking Company seems to have received the check as an agent for Malloy Brothers, to the world it appeared to be the holder. The record does not disclose the relation of the Atlantic National Bank of Jacksonville to the Perry Banking Company. The Atlantic National Bank may have been an agent for the Perry Banking Company, but for aught that appears in the record the check may have been transferred to the Atlantic National Bank for value and that bank may have become the holder in due course. The Citizens & Southern Bank received it for the credit of the Atlantic National Bank upon the terms set forth in the record (Transcript, page 41), but appears to have known of the interest of no party other than the Atlantic National Bank. The Federal Reserve Bank of Richmond received the check from the Citizens & Southern Bank for the account of the Federal Reserve Bank of Atlanta upon the terms and conditions which we have stated. It knew only the Citizens & Southern Bank and the Federal Reserve Bank of Atlanta, and had no notice of the interest of any other person whatsoever in the check (Testimony of L. A. Wingo, Transcript, page 55).

In such cases it seems to be established in the lower Federal courts that each bank is liable to its predecessor and only to its predecessor. In *Taylor-Bournique* vs. *National Bank of Ashtabula*, 262 Federal 168, at page 172 the court says:

> "I am of the opinion that plaintiff may maintain an action only against the bank with which it made a contract for collection and not against any

other bank to which the receiving bank may forward it."

Balcomb vs. *Old National Bank*, 201 Federal 679, seems to be to the same effect, and the same rule had been recently applied by an inferior Federal court in the case of *First National Bank of Denver* vs. *Federal Reserve Bank of Kansas City*, 283 Federal 700. In this case, at page 701, the court says (italics ours):

> "The Hallack & Howard Lumber Company and the defendant, the Federal Reserve Bank of Kansas City (Denver Branch), which was selected by the plaintiff as a sub-agent to make the collection, are entire strangers, and the former, according to the *rule of the Federal courts* and the courts of Colorado, *has no right of action against the defendant*. See *Hoover* vs. *Wise*, 91 U. S. 308, 23 L. Ed. 392; *Exchange National Bank* vs. *Third National Bank*, 112 U. S. 276, 41 Sup. Ct. 499, 28 L. Ed. 722; *Taylor-Bournique* vs. *National Bank of Ashtabula*, 262 Fed. 168; *First National Bank of Denver* vs. *Manhattan Life Insurance Co.*, 21 Colo. App. 256, 120 Pac. 1112; and *Manhattan Life Ins. Co.* vs. *First National Bank of Denver*, 20 Colorado App. 529, 80 Pac. 467."

While this court does not appear to have decided the particular point, the Federal decisions quoted above appear to follow in logical sequence the decisions of this court in *Hoover* vs. *Wise*, 91 U. S. 308, 23 L. Ed. 392, and *Exchange National Bank* vs. *Third National Bank*, 112 U. S. 276, 41 Sup. Ct. 499, 28 L. Ed. 722.

We concede that the state courts are not unanimous upon this precise point. There are, however, many states which have followed the rule adopted by the lower Federal courts, as, for example, in the following cases: *Cohen* vs. *Tradesmen National Bank*, 262 Pa. 76, 105 Atlantic 43; *Montgomery County Bank* vs. *Albany City Bank*, 7 New York 459.

Since the rule is one which involves general com-

mercial law, it is one upon which the Federal courts do not, of necessity, follow the state decisions.

There Could Have Been no Contractual Relation Between Malloy Brothers and the Federal Reserve Bank of Richmond.

Federal Reserve Banks can receive checks on deposit or for collection only for the account of member banks, non-member banks which have opened clearing accounts, other Federal Reserve Banks, and the United States and certain other public agencies, such as the War Finance Corporation. Therefore, the Federal Reserve Bank of Richmond could not have made an agreement binding it to act as the agent of Malloy Brothers and to be accountable to them, as such an agreement would have been *ultra vires* and void, and no action would lie upon it. We, therefore, respectfully submit that the Federal Reserve Bank of Richmond could not in law, and did not in fact, contract with Malloy Brothers. Hence, no action can be maintained against it by them. The Federal Reserve Bank of Richmond is answerable for its actions to the Federal Reserve Bank of Atlanta and the Citizens & Southern Bank with which it contracted, and to no other person. Malloy Brothers may maintain an action against the Perry Banking Company, which is their agent, and against no other person.

THE FEDERAL RESERVE BANK OF RICHMOND ACCEPTED THE CHECK FOR COLLECTION UPON CONDITION THAT IT WOULD BE SENT TO THE DRAWEE FOR REMITTANCE IN THE USUAL WAY.

If the court be of the opinion that Malloy Brothers can maintain this action at all, we think that it is undeniable that they can do so only upon the theory adopted by the trial court, i. e., that the Citizens & Southern Bank

is their agent and they were, therefore, privy to the contract made between the Citizens & Southern Bank and the Federal Reserve Bank of Atlanta, to which contract the Federal Reserve Bank of Richmond was likewise privy. But since the Citizens & Southern Bank was the holder of a check endorsed in blank, and Malloy Brothers' real interest, if it existed, was unknown, if they sue upon the contract made by the Citizens & Southern Bank they ratify it in all things and stand exactly in the shoes of their agent.

This contract was made in Georgia and was between two Federal Reserve Banks and a member bank. If a Federal law or regulation was applicable, it would control. If no Federal law was applicable, the contract must be regarded as one made in Georgia to be performed in North Carolina.

The learned judge below held, and, we think, correctly, that Regulation J established a complete rule for determining the rights of the parties, for he says, "This regulation, to the extent of its permissive provisions, must be taken to have been known to the Citizens & Southern Bank of Atlanta and the Federal Reserve Bank of Atlanta." (Transcript, page 47.)

The regulations of the Federal Reserve Board were intended to govern the operation of Federal Reserve Banks in establishing a method for the collection of checks in every state in the Union. In order to properly understand them, we must take into consideration the methods and practices in common use among bankers and the law relating to the duties and obligations of a collecting bank.

If a bank in one town receives on deposit or for collection a check payable in another town, there are three possible ways by which it may be collected:

1. The collecting bank may dispatch a special messenger to the place where the check is payable and for-

mally present the check and receive payment of the amount in cash, and bring the cash back to the collecting bank.

2. The check may be sent to some suitable agency at the place of payment, and this sub-agent may collect it and make settlement for the amount.

3. The collecting bank may send the check directly to the bank on which it is drawn under some arrangement whereby this bank will make remittance for the check, if it be good.

The first method is obviously too expensive and cumbersome for ordinary use, as this court recognized in *Farmers and Merchants Bank* vs. *Federal Reserve Bank of Richmond*, decided June 11th, 1923, 43 S. Ct. Rep. 641. It is a matter of common knowledge that it is not used in practice.

The second and third methods are in general use among the banks of this country, the choice between them depending upon the circumstances of each case. The third is perhaps the simplest and most expeditious; and when, as in this case, the drawee is the only bank in its town, the third is the one practical method.

There is an irreconcilable conflict in the decisions of the various state courts upon the question of the nature of the responsibility which should be inferred or implied from the mere act of accepting a check for collection when there is no express contract setting forth the liability of the collecting bank. Many courts, headed by this court, have held that, if there was no contract or agreement showing a different intention, it is fair to infer that the bank in which the check is first deposited undertakes the collection of it as an independent contractor, and that the general contractor is liable for all defaults of all sub-contractors. This view is commonly called the New York rule.

Other courts hold that the depositor should know that the bank in which he deposits a check does not undertake to do business in a distant city, and that, therefore, in the absence of express agreement, it is fair to infer that the depositor intends to authorize his bank to select a suitable sub-agent on his behalf, and that the collecting bank undertakes only to exercise prudence and care in selecting suitable sub-agents, and to forward the check to this sub-agent for collection. This is called the Massachusetts rule.

A full discussion of these divergent views will be found in *Exchange National Bank* vs. *Third National Bank*, 112 U. S. 276, and *Bank* vs. *Triplet*, 1 Pet. 25, and also in 3 Ruling Case Law, page 623, title "Banks," Sections 251-2.

In those jurisdictions in which the courts adhere to the so-called Massachusetts rule, there is some diversity of opinion as to whether or not the drawee is a proper sub-agent. The majority of courts hold that it is never proper to select the drawee as a sub-agent, for the drawee always has an interest adverse to the holder of the check. See *Bank of Rocky Mount* vs. *Floyd*, 142 N. C. 187, and 3 Ruling Case Law, page 627, title "Banks," Section 255-6-7. Some courts, however, recognize that under modern conditions the risks incident to the method of collecting a check by sending it to the drawee for remittance were no greater than those incident to the employment of some independent agent in the same place. See *Hilsinger* vs. *Trickett*, 86 Ohio State 286, 99 N. E. 305; *Kershaw* vs. *Ladd*, 56 Pac. 402, 34 Ore. 375; *Wilson* vs. *Carlinville National Bank*, 187 Ill. 22, 58 N. E. 250, 52 L. R. A. 632.

All courts seem to be agreed that if there was an express contract defining the relationship and liability of the bank to its depositor, the terms of this contract would control.

The pertinent portion of Regulation J is as follows (italics ours):

> "In handling items for member and non-member clearing banks, a Federal Reserve Bank will act *as agent only.* The Board will require that each member and non-member clearing bank authorize its Federal Reserve Bank *to send checks for collection to banks on which checks are drawn,* and *except for negligence,* Federal Reserve Banks will assume no liability."

If we study the above quotation in the light of the banking practices outlined above and the conflict in judicial opinion, its meaning is obvious. The Federal Reserve Banks operate in all states. It was very desirable to have a uniform rule of liability and a uniform method of operation. The Board, therefore, promulgated a regulation which would form a *quasi* contract between the Federal Reserve Banks and their depositors, the member banks and other Federal Reserve Banks. This regulation established:

1. That the Federal Reserve Bank should be a forwarding agent only and not an independent contractor; that is to say, it should not assume responsibility for the defaults of the sub-agents to which it might send the checks.

2. That they might employ the drawee as sub-agent and send the check to the drawee for collection and remittance, and might after that, in collecting from the drawee, follow the usual method common among prudent bankers.

Authority to Send Checks Directly to the Drawee, Implies Authority to Accept Exchange Draft From Drawee.

The learned judge of the district court held that the Federal Reserve Bank of Richmond was a forwarding agent only, and could send the check directly to the drawee, but, notwithstanding this, held that the Federal

Reserve Bank must insist that settlement be made in actual money and must, at its peril, keep itself in a position to prevent the drawee from cancelling the check until cash was actually in the hands of the Federal Reserve Bank. We contend that such interpretation and application of the regulation renders it practically of no effect, and fails to take into account the obvious intent of the Board which promulgated it.

The phrase "to send checks for collection to banks on which checks are drawn" obviously does not express a complete idea. A check cannot be collected merely by sending it for collection to the bank on which it is drawn. After the drawee bank has collected the check by charging it to the drawee and thus becoming the debtor of the holder, something further must be done. We contend that the phrase is, by necessary implication, completed as follows: "Send checks to the banks on which checks are drawn for collection *and remittance in the usual and ordinary manner.*" This meaning is made clearer by the additional expression, "and except for negligence, such Federal Reserve Banks will assume no liability," for negligence is in substance a departure from the course of conduct usually followed by prudent men!

It is a matter of common knowledge that banks usually settle between themselves by means of drafts. There was positive and uncontradicted evidence to this effect, for Edward Waller, Jr., an Assistant Cashier of the Federal Reserve Bank of Richmond, testified as follows (Transcript, page 66):

> "I am thirty-one years of age, and am Assistant Cashier of the Federal Reserve Bank of Richmond, having general supervision of the Transit, Bookkeeping and Adjustment & Transfer Departments. I held this position on December 24, 1920. . . .
>
> "I have been in the banking business since February, 1910. The business of check collecting is handled by the Federal Reserve Bank in a way very

similar to that in which it is handled by collecting banks throughout the country. When one bank receives checks on another in a distant city, it usually sends them to the bank upon which they are drawn or to some other bank in that city, and receives settlement by means of an exchange draft drawn by the bank to which the checks are sent upon some one of its correspondents. When checks are sent with the expectation that the bank receiving them will remit at once, we call it sending for collection and return. When this is done, the bank upon which the checks are drawn is expected to cancel the checks and charge them to the accounts of the drawers and to remit by means of its exchange draft or by a shipment of currency. An exchange draft is used more frequently than a shipment of currency."

The learned judge below appeared to consider that this testimony was irrelevant, because there was no evidence that Malloy Brothers knew of the custom of the banks; but this view is plainly unsound, for we think he overlooked the fact that this testimony was not offered to prove that the Federal Reserve Banks were authorized to send checks directly to the banks on which they were drawn. That authority was conferred by the regulations of the Federal Reserve Board, which had been accepted by, and were of their own force binding upon, the Citizens & Southern Bank, the agent of Malloy Brothers. The evidence of custom was introduced to show the intent and meaning of the regulations of the Federal Reserve Board as expressed in the regulations. This Board is charged with the duty of supervising banks and is conversant with their customs. The regulations were addressed to bankers, who, of necessity, know their own customs, and should, therefore, be considered and interpreted in the light of customs and usages generally followed in the banking business.

Regulation J provided that Federal Reserve Banks should send checks directly to the drawee without assuming liability, except for negligence. Negligence is

by definition the failure to use those means which men of ordinary prudence employ when their own interest is involved. If the Federal Reserve Bank followed a general custom used in like cases by prudent bankers, Malloy's ignorance could not enter into or affect the definition of negligence.

The custom to which we have alluded is so generally known that courts take judicial notice of it. In *Bank* vs. *Davis*, 114 N. C. 343, at page 345, the court said (italics ours):

> "Now it is a well known and established custom of banks when acting as collecting agents either for other banks or indeed for any customer, to put all collections made by them into the general fund of the bank, unless directed to make of them a special deposit, and use them from hour to hour and from day to day in the transaction of their current business, and, when the day or the hour arrives for making remittances, send to the bank or other customer for whom the collection was made, not the identical currency or money collected, but money or currency taken from the general fund without reference to its identity, or, as is *far oftener done, its cashier's check on itself or some other bank*, or in some way to effect settlement."

In *First National Bank of Richmond* vs. *Wilmington & Weldon Railway*, 70 Federal 401, a case decided by the Circuit Court of Appeals for the Fourth Circuit, the court said (italics ours):

> "The custom of banks does not require a collecting bank to keep money separate and apart from all others in its possession, and to remit that very money to the bank for which it made the collection; *and the courts will take judicial cognizance of this fact.* If this were not so, and if the payer and drawer of a draft were bound to look to the transmission of the very money paid upon it, an important branch of the business of banks would be discon-

tinued, and the sending of money by express would become necessary in all cases of collection, to the great inconvenience of bankers."

In *Farmers Bank & Trust Co.* vs. *Newland*, 31 S. W. 38, 97 Ky. 464, the court said:

"If this (acceptance of checks) cannot be done, then the only course left for a bank to pursue is to send an agent to the point where the collection is to be made, or to have the bank or agent at that point send by express or other means of transportation the proceeds of the collection in money. This is not regarded as safe, by the most prudent business men, as to transfer money through the medium of checks and drafts. It is cumbersome and would be a most unsatisfactory way to transact business."

In *American Bank & Trust Co.* vs. *Federal Reserve Bank of Atlanta*, opinion delivered June 11, 1923, 43 St. Ct. Rep. 649, this court alluded to the custom as a matter of general knowledge, saying (italics ours):

"A large part of the checks drawn on country banks are sent to payees who reside in place other than that in which the drawee bank is located. Payment of such a check is ordinarily secured through the payee's depositing it in his local bank for collection. This bank ordinarily used, as the means for presenting the check to the drawee, a clearing house and / or correspondent banks. Formerly when the check was so presented, the drawee ordinarily paid, *not in cash, but by a remittance drawn on his balance in some reserve city* or by a credit with some correspondent."

The court will doubtless recall that in the above mentioned case against the Atlanta bank, the state banks charged that a demand for payment in cash was so unusual as to show malice and amount to coercion. (*American Bank & Trust Co.* vs. *Federal Reserve Bank of Atlanta*, 256 U. S. 350.) The court did not find it necessary

to decide the point, since the answer of the Federal Reserve Bank of Atlanta and the evidence in the case showed no intent to insist upon cash when remittance drafts were tendered, but at least one inferior Federal court has said that the insistence upon settlements in cash only was coercive and oppressive. (*Brookings State Bank* vs. *Federal Reserve Bank of San Francisco*, 277 Fed. 430, 281 Fed. 222.)

It seems to us that in the present case the courts below have decided that the Federal Reserve Banks must insist upon settlement in cash and in cash only when collecting checks upon non-member banks, and the Federal Reserve Banks are thus placed in a position that if they demand cash they may with some color be charged with coercion and oppression, but if they accept anything but cash they are adjudged guilty of negligence.

The Acceptance of Exchange Draft Was Not Direct Cause of Loss.

We think that another reason why it was error for the court to hold that the Federal Reserve Bank of Richmond is liable to Malloy Brothers because of the acceptance of the exchange draft is that the acceptance of the exchange draft did not of itself occasion any loss to Malloy Brothers. If a check drawn upon a bank be sent to that bank for collection, it is obvious that the drawee bank can collect it only by charging it to the account of the drawer. When this is done the drawer is released, and the drawee bank, which is also the collecting agent, becomes a debtor to the holder. There can be no doubt of this proposition, for it has been decided by this court in *American National Bank* vs. *Miller*, 229 U. S. 517, in which case, at page 520, Justice Lamar said:

> "There are some disadvantages of sending a check for collection directly to the bank on which it is drawn, but when such bank performs the dual

> function of collecting and crediting the transaction is closed, and, in the absence of fraud or mutual mistake, is equivalent to payment in usual course."

The same conclusion was reached in the case of *Rocky Mount* vs. *Floyd*, 142 N. C. 187, in which the drawee bank charged a check to the drawer but sent no remittance, and the court nevertheless held that the drawer was released. This last mentioned case was decided by Judge Henry G. Connor, who decided the case at bar in the District Court of the United States for the Eastern District of North Carolina, and who was formerly a member of the Supreme Court of North Carolina. In the case at bar the learned judge, in passing upon the liability of Balfour, held that Balfour was released as soon as the check drawn by him was cancelled and charged to his account, for he says.

> "It is well settled by these, and other authorities, as well as upon principle, that when the Cashier of the Lumber Bridge Bank stamped the check 'Paid,' charged it to his account and delivered it to Balfour, who had to his credit, subject to his check, an amount more than sufficient to pay his check, that the check was paid and his liability as maker or drawer discharged."

No exception to this ruling was taken by any party and it seems clearly correct. It is, therefore, very obvious, under well established authority and under the decision of the court in this case, that the instant that the Cashier of the Bank of Lumber Bridge stamped Balfour's check "Paid," Balfour was released, and the Bank of Lumber Bridge became liable to the holder of the check. At this time no exchange draft had been sent or accepted. The learned judge below held that the Federal Reserve Bank was authorized to send the check directly to the Bank of Lumber Bridge. It was, therefore, clear that at the time of the cancellation of the check the Fed-

eral Reserve Bank of Richmond had not made itself liable, for it had done nothing except send the check to the Bank of Lumber Bridge, upon which it was drawn. Since that time nothing has happened which has altered the situation of the parties. Balfour was then released and the holder of the check had a right of action against the Bank of Lumber Bridge, which was a debtor to the holder. The Bank of Lumber Bridge is still a debtor to the holder. It is true that the Bank of Lumber Bridge has now been adjudged insolvent, but it was, in fact, insolvent at that time. The sending of the exchange draft was a mere effort on the part of the Bank of Lumber Bridge to pay a debt which it owed. The acceptance of the exchange draft was merely a step made by the Federal Reserve Bank in the direction of securing payment from the Bank of Lumber Bridge—a natural and proper step. If the Federal Reserve Bank had refused the exchange draft and demanded a shipment of currency, this refusal would not have revived the liability of Balfour; and the Bank of Lumber Bridge could not have made the shipment of currency, so that it follows that a refusal of the exchange draft by the Federal Reserve Bank of Richmond would have had no effect upon the present situation, except that the holder of the check would then have had a right of action against the Bank of Lumber Bridge upon an open account. It now has a right of action against the Bank of Lumber Bridge as the drawer of the dishonored draft. The situation of the holder in either case is exactly the same.

If we take the view apparently taken by the trial court and say that the Federal Reserve Bank of Richmond was authorized to send this check directly to the Bank of Lumber Bridge, but was bound to see to it that the Bank of Lumber Bridge did not cancel the check until the proceeds were actually in the hands of the Federal Reserve Bank of Richmond, it is obvious that the Federal Reserve Bank of Richmond must then find some way by

which it could surrender the check into the hands of the Bank of Lumber Bridge and yet retain control over the Bank of Lumber Bridge. We respectfully submit that no practical system of handling checks can be devised under which the Federal Reserve Bank of Richmond, located at Richmond, Virginia, can send a check to the drawee in a town several hundred miles away and still retain control over the actions of the drawee, and prevent the drawee from cancelling the check until remittance has been made. To send directly to the drawee means to rely upon the good faith and credit of the drawee or it means nothing.

If the Federal Reserve Bank of Richmond be held liable because the drawee defaults, it is held liable for a loss arising out of the business of collecting checks, which prudence could not foresee and diligence could not avert. Such a loss is obviously not one due to negligence. In fact, the trial court concedes that the term "negligence" could not with accuracy be applied to anything which the Federal Reserve Bank of Richmond had done, for it says (italics ours):

> "I am of the opinion that the defendant, Federal Reserve Bank of Richmond, was not authorized to accept in payment of the proceeds of the check from the Lumber Bridge Bank, its check or draft on the Greensboro Bank and that, in doing it, was negligent, *or probably to state the situation more clearly*, it exceeded its authority and is liable to plaintiffs for the amount of the Balfour check."

We respectfully submit that if acceptance of the exchange draft cannot be aptly termed negligence, the acceptance of it by the Federal Reserve Bank of Richmond could not render it liable to Balfour, for it had received the check for collection upon condition that it should be liable for nothing *except negligence*.

CERTAIN CASES CITED BY THE TRIAL COURT DISTINGUISHED.

The court below cites many cases supporting the rule of law which the court states as follows (italics ours):

> "The authorities appear to be practically uniform in holding that, *in the absence of any instruction or permission from the owner of the check*, or any custom brought to the notice of such owner to the contrary the bank had no authority to accept or receive in payment of the check entrusted to it for collection anything other than money."

The cases relied on by the courts deal with banks which were collecting instruments payable in the town where the bank does business. In such a case it is easy to present the instrument in a formal manner—that is to say, exhibit it to the drawee—and yet retain possession until the drawee has made payment. Such cases can have no application to the collection of a check at a distant point. These cases, if closely examined, do not condemn the mere acceptance of something other than money. They condemn as negligent the act of surrendering a negotiable instrument to the drawee before payment is made, and hold that a collecting agent never has the right to do this unless expressly authorized. We concede that these cases state the correct view but they are obviously inapplicable to the present case. The Federal Reserve Bank of Richmond could not present an instrument to the drawee in Lumber Bridge and yet retain control of it, unless it sent an agent to Lumber Bridge for that purpose. The Board, therefore, in order that Federal Reserve Banks might handle checks received for collection in the ordinary way, required every member bank to authorize the Federal Reserve Banks to send checks to the drawee for collection; i. e.,

surrender the check to the drawee. The holders, through their agent, the Citizens & Southern Bank, agreed that the check could be handled in accordance with the Regulations of the Board. The Federal Reserve Bank, therefore, had express authority to surrender the check before receiving payment, and the courts have all conceded that an agent may do this if his principal has authorized the act.

CONCLUSION OF ARGUMENT ON ASSIGNMENT NO. 1.

We respectfully submit that the courts below erred in this case, because:

1. It appeared that Malloy Brothers were strangers in fact and in law to the Federal Reserve Bank of Richmond, which had undertaken to act as agent for the Citizens & Southern Bank and the Federal Reserve Bank of Atlanta only, and, therefore, Malloy Brothers cannot maintain this action.

2. It appeared that the terms and conditions under which the Federal Reserve Bank of Richmond accepted this check as agent for collection were that it should have authority to send the check directly to the drawee and should not be liable except for negligence. It appeared from the uncontradicted testimony that the Federal Reserve Bank of Richmond sent the check to the drawee and was faithful and diligent in its efforts to secure remittance from the drawee, and that in accepting an exchange draft from the drawee, after sending the check to the drawee, the Federal Reserve Bank of Richmond was following the usual and ordinary course of business among bankers and a course which necessarily followed the act of sending the check to the drawee. The acceptance of the exchange draft was not of itself a ground of

liability, because the loss to Malloy Brothers was complete when Balfour was released. The release of Balfour was occasioned by the cancellation of his check, so that after the check of Balfour was cancelled the acceptance of the exchange draft in no way altered the relations of the parties.

ARGUMENT ON SECOND ASSIGNMENT OF ERROR.

The second assignment of error is as follows (Transcript, pp. 73 and 85):

> "The Circuit Court of Appeals erred in failing and refusing to set aside the judgment entered by the District Court of the United States for the Eastern District of North Carolina, for that the said District Court found as follows:
>
> 'There is no evidence of any custom existing either in Virginia or North Carolina, by which collecting banks are authorized to accept from their agents or sub-agents, or from the drawee banks in settlement of collections sent them, anything other than money in settlement of such collections. Plaintiff, J. H. Malloy, testified that he was engaged in the lumber business and knew "very little about the workings of a bank—did not instruct the Perry Banking Co.—just sent the check down there for credit during the course of business." '
>
> which finding made by the said District Court was wholly without evidence to support it and contrary to and in conflict with the facts as shown by the uncontradicted testimony of Edward Waller, Jr., M. W. Bell, J. E. Wallace, and others, from which testimony it appeared that there was a custom existing and generally known to all Federal reserve banks, commercial banks and others engaged in the business of collecting checks in Virginia, North Carolina, and elsewhere, whereby banks made settlement with each other for collections sent to them by means of exchange drafts drawn upon their correspondents."

It may be that this assignment of error presents only a misapprehension of the trial court of the effect and purpose of certain evidence and does not deal with a finding of the court on an ultimate fact.

If the above quoted passage of the opinion of the

court means that there was no evidence that banks commonly use exchange drafts as a medium of settlement between themselves, it is plain that the court disregarded the uncontradicted testimony of Edward Waller, Jr., quoted, *supra*, pages 17 & 18, and the cases cited in this brief, pages 19 & 20, show that the custom is a matter of common and general notice, of which the courts take judicial notice without evidence.

If the quotation in the opinion means that Malloy Brothers knew nothing of the custom, and the evidence is, therefore, irrelevant in a suit brought by them, it is inconsistent with the position taken by the court in holding that the Citizens & Southern Bank was the agent of Malloy Brothers. The knowledge of the agent is imputable to the principal, and the Citizens & Southern Bank must be held to knowledge of the ordinary custom of banks, and must have contemplated that checks sent for collection to a Federal Reserve Bank for the credit of another bank would be handled in the ordinary way.

If the statement means that, although banks usually accept drafts in settlement for out-of town collections, there is no evidence that they are usually authorized by their depositors to do so, then we think it is clear that the court has misapprehended the object of the testimony embodied in Bill of Exception No. 2. The testimony was not offered to show the relations which usually exist between a bank and its customer, but to show the general practice of banks when collecting checks; for the regulations of the Federal Reserve Board, prepared by bankers for bankers, must be read in the light of existing conditions and established practices.

We have in our argument under Assignment No. 1 endeavored to point out the true application of this testimony and we will not here repeat it.

ARGUMENT ON THIRD ASSIGNMENT OF ERRO

Assignment of error No. 3 is as follows (Transcrip pp. 73 and 85):

> "The Circuit Court of Appeals erred in affirm ing the judgment entered in this cause by the Di trict Court of the United States for the Easter District of North Carolina, and in not reversin said judgment, for that it appeared from the fact as found and stated by the District Court of th United States for the Eastern District of Nort Carolina, that the Federal Reserve Bank of Rich mond was in no way liable to the defendant in erro yet, nevertheless, the said District Court of th United States for the Eastern District entered judg ment in favor of the defendant in error and again the plaintiff in error."

This assignment presents the contention that, the statement of facts made by the trial judge, jud ment should have been given for the Federal Reser Bank of Richmond. Since we concede that the stat ment of facts made by the trial judge, which was adopte and approved by the Circuit Court of Appeals, correct sets forth the material facts in the case, except in so f as there may be some ambiguity in the portion of t statement dealing with the testimony establishing t general custom of banks, which is discussed under A signment of Error No. 2, it is obvious that all we ha said with respect to the first assignment of error appli to the third. The two assignments present but one prop sition, i. e., upon the undisputed facts the plaintiff b low, defendant in error here, was not entitled to recov a judgment against the Federal Reserve Bank of Ric mond.

Respectfully submitted this 20th day of Novembe 1923.

M. G. WALLACE,
Counsel for Federal Reserve Bank
of Richmond, plaintiff in error.

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DEC 20
WM. R. ST

BRIEF FOR DEFENDANTS IN ERROR.

Supreme Court of the United States

OCTOBER TERM, 1923.

No. 553.

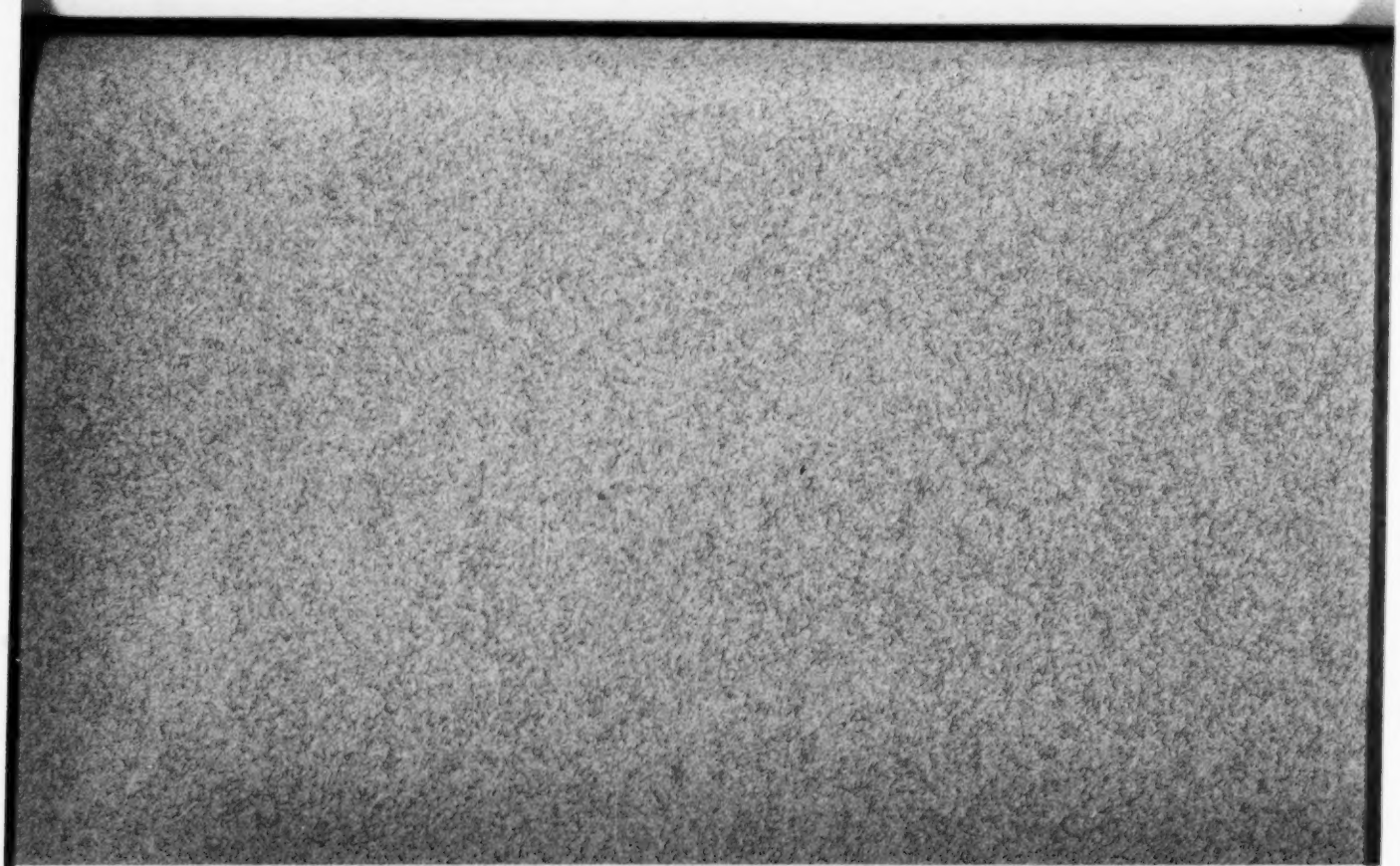
FEDERAL RESERVE BANK OF RICHMOND,
PLAINTIFF IN ERROR,

versus

D. J. MALLOY & J. H. MALLOY, TRADING AS MALLOY BROTHERS, DEFENDANTS IN ERROR.

IN ERROR TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

(29,863.)



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(29,863.)

Supreme Court of the United States

OCTOBER TERM, 1923.

No. 553.

FEDERAL RESERVE BANK OF RICHMOND,
PLAINTIFF IN ERROR,

versus

D. J. MALLOY & J. H. MALLOY, TRADING AS MALLOY BROTHERS, DEFENDANTS IN ERROR.

IN ERROR TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

STATEMENT OF FACTS.

This writ of error is presented by the Federal Reserve Bank of Richmond to review a judgment of the Circuit Court of Appeals for the Fourth Judicial Cir-

cuit, affirming *in toto* the findings of fact, opinion and judgment of the District Court of the United States for the Eastern District of North Carolina, to which the action was removed by petition from the Superior Court of Cumberland County, North Carolina, wherein D. J. Malloy and J. H. Malloy, partners, trading as Malloy Brothers, of Quitman, Georgia, defendants in error, were plaintiffs, and Federal Reserve Bank of Richmond, plaintiff in error, and Napier H. G. Balfour were defendants. A jury trial was waived, and his Honor H. G. Connor, District Judge, found the facts (Record, p. 14). It was adjudged that Malloy Brothers recover of the Federal Reserve Bank of Richmond nine thousand dollars, interest and costs (Record, pp. 29 and 81), because of a $9,000 check on the Bank of Lumber Bridge, Lumber Bridge, North Carolina, of November 30th, 1920, drawn by Balfour and mailed to Malloy Brothers as a partial payment on his $15,000 purchase money mortgage for a farm in Robeson County, North Carolina, which check they received, endorsed and mailed December 2nd, for collection, to the Perry Banking Company, Perry, Florida, their banking town (pp. 32-34). This bank issued to Malloy Brothers a credit slip therefor which provided: "Checks, drafts, etc., received for collection or deposit are taken at the risk of the endorser until actual final payment is received" (p. 33). This check, passing through the Atlantic National Bank, Jacksonville, Florida, and Citizens and Southern Bank, Atlanta, Georgia, reached the Federal Reserve Bank of Richmond for collection, and it sent it on December 10th direct to the bank on which it was drawn, the Bank of Lumber Bridge, which marked the check "paid," charged it to Balfour's account, which had more than $9,000 to his credit, and on December 14th, 1920, sent in payment of this and some other items its own worthless draft for $9,204.90 on the Atlantic Bank and Trust Company, Greensboro, N. C., which the Richmond bank accepted (pp. 9-10); and on the 15th forwarded it to the bank at

Greensboro, which wired plaintiff in error on the 17th that it was not then good, and the Richmond bank wired the Lumber Bridge bank. Later in the same day the draft was protested for non-payment and returned, and plaintiff in error was so advised by wire (p. 53). On the same day the Lumber Bridge bank replied by wire that the matter was being adjusted (p. 54). Nothing more was done about the matter until the 20th, when the plaintiff in error sent a representative to Lumber Bridge to procure a settlement (p. 60). On the 21st, four days after the wired advice of the protest, the Federal Reserve Bank of Richmond wired the Citizens and Southern Bank, of Atlanta, that the $9,000 check was unpaid and that it was charged back (p. 55). To the cashier of the Atlanta bank it seemed rather a long time to report on an item of this kind so he complained to the Richmond bank (pp. 46, 57), which replied that they thought it only fair that they should have communicated with the Lumber Bridge bank to see what explanation they had to offer before attempting to advise the endorsers on the items represented by the draft, that they were using every effort to get in touch with the Lumber Bridge bank but were unsuccessful, and that they had made arrangements to take care of their draft (p. 58). The record discloses no such arrangement. The Lumber Bridge bank was closed on the 24th (pp. 3, 7, 62).

Balfour's check was returned to him by the bank (p. 34), and no appeal was taken from that portion of the judgment discharging him from liability.

Malloy Brothers received no money for the check, and it was charged back to them by the Perry bank December 21st or 22nd (p. 32). The Bank of Lumber Bridge received the Balfour check on the 11th (p. 52), and sent its $9,204.90 draft on the 14th. Evidence of its financial condition on and after the 14th is shown on pages 35, 62-65 of the record. The findings of fact show (p. 28): "The Lumber Bridge Bank had, on Decem-

ber 14th, $16,816.00 and, so far as appears, on December 24th, 1920, when it went into the hands of a receiver, cash $4,574.00, and which, with balances in other banks aggregated about $11,000.00. It held also bills and notes to an amount not stated in the evidence."

In October, 1920, an employee of the Federal Reserve of Richmond, whose duty was to make agreements for banks to remit at par for their checks sent them, saw the cashier of the Bank of Lumber Bridge about remitting for checks, and he was told by the cashier that when plaintiff in error undertook to collect checks on all other banks in North Carolina it could send him his checks and he would remit for them, but the cashier would not sign an agreement to this effect, and he was told by this employee that he could remit either by draft or shipment of currency at the expense of the Richmond bank (p. 60). The record does not show that this condition was ever met by plaintiff in error. There is an allegation in the answer (article 3, p. 9) that the Bank of Lumber Bridge would, upon the day of receipt, return such checks as it was unwilling to pay and would remit for such checks as it desired to pay by means of its good exchange draft drawn upon some bank with which the Bank of Lumber Bridge kept an account and in which it had funds upon deposit. The Bank of Lumber Bridge was not a member of the Federal Reserve System (p. 52). It was not unusual for remittance drafts sent plaintiff in error by small banks to be dishonored (p. 62).

The Florida statute, approved June 8, 1909, mentioned in the opinion of the District Court (p. 19), is as follows:

> "Section 1. That when a check, draft, note, or other negotiable instrument is deposited in a bank for credit or for collection, it shall be considered due diligence on the part of the bank in the collection of

any check, draft, note, or other negotiable instrument so deposited, to forward *en route* the same without delay in the usual commercial way in use according to the regular course of business of banks, and that the maker, indorser, guarantor, or surety of any check, draft, note, or other negotiable instrument, so deposited, shall be liable to the bank until actual final payment is received, and that when a bank receives for collection any check, draft, note, or other negotiable instrument, and forwards the same for collection, as herein provided, it shall only be liable after actual final payment is received by it, except in case of want of due diligence on its part, as aforesaid."

CONTENTIONS OF MALLOY BROTHERS.

Briefly stated, the defendants in error allege that by operation of law the Federal Reserve Bank of Richmond became their agent to collect the check; and that it was negligent: (1) in sending and surrendering the same to the drawee bank; (2) in accepting a worthless draft in payment, and that by so doing it made the draft its own; and (3) in failing to give prompt notice of the non-payment of the exchange draft and affording them an opportunity to collect from the Bank of Lumber Bridge before it was closed.

CONTENTIONS OF THE FEDERAL RESERVE BANK OF RICHMOND.

The plaintiff in error alleges: (1) that it was not an agent for Malloy Brothers because it had no agreement with them, and was responsible, if at all, solely to the Atlanta banks; and (2) that even if it were Malloy Brothers' agent it was not guilty of negligence because of a contract with the Citizens and Southern Bank permitting direct sending and under authority of the Federal Reserve Board; also that custom justified direct sending and acceptance of the exchange draft; and also

that prompt notice would have availed Malloy Brothers nothing.

The court held that the plaintiff in error was agent of defendants in error; that the regulation of the Federal Reserve Board entered into the contract between plaintiff in error and the Atlanta banks and justified the direct sending; that no negligence was committed by plaintiff in error so far as the prompt handling of the check and draft were concerned; but that the Federal Reserve Bank of Richmond exceeded its authority in accepting anything but money in payment of the check.

ARGUMENT.

FIRST ASSIGNMENT OF ERROR.

This assignment is in effect that the judgment should have been for the plaintiff in error and it, therefore, practically covers the entire case.

THE FEDERAL RESERVE BANK OF RICHMOND WAS THE AGENT OF MALLOY BROTHERS.

The first question raised by plaintiff in error is Malloy Brothers' right to maintain this action against it. We submit that his Honor, Judge Connor, was correct in holding that the Florida act above quoted made the engagement of the Perry bank such that the collecting bank, if properly selected, became the sub-agent of and accountable to defendants in error (Record, pp. 19, *et seq*). It is held in *Exchange National Bank* v. *Third National Bank*, 112 U. S. 276, 28 L. Ed. 722 at 727, that:

> "The distinction between the liability of one who contracts to do a thing and that of one who merely receives a delegation of authority to act for another is a fundamental one, applicable to the present case. * * * Whether a draft is payable in the place where the bank receiving it for collection is

situated, or in another place, the holder is aware that the collection must be made by a competent agent. In either case, there is an implied contract of the bank that the proper measures shall be used to collect the draft, and a right, on the part of its owner, to presume that proper agents will be employed, he having no knowledge of the agents. There is, therefore, no reason for liability or exemption from liability in the one case which does not apply to the other. And, while the rule of law is thus general, the liability of the bank may be varied by consent, or the bank may refuse to undertake the collection. It may agree to receive the paper only for transmission to its correspondent and thus make a different contract and become responsible only for good faith and due discretion in the choice of an agent. * * * The nature of the contract is the test."

For other cases holding that the liability of a bank taking a commercial paper for collection *at home or abroad* whatever it may be without a special agreement or understanding, may certainly be fixed or varied by a special contract at the outset of the transaction, see a great number of cases cited in note in *Brown* v. *Peoples Bank*, 52 L. R. A. N. S., at p. 634.

It is clearly established that whenever, by express agreement between the parties, a sub-agent is to be employed to receive money for the principal, such sub-agent shall be deemed an agent of the principal. *Wilson* v. *Smith*, 3 How. 763, 11 L. Ed. 820; *Miller* v. *Farmer's and Merchant's Bank*, 30 Md. 292; *Farmer's Bank* v. *Owen*, 5 Cranch. C. C. 504, Fed. Cas. No. 4662; *Bank of Lindsborg* v. *Ober*, 31 Kan. 599, 3 Pac. 324; *City Natl. Bank* v. *Cooper*, 91 S. C. 91, 74 S. E. 366; *Bank of Washington* v. *Triplett*, 1 Pet. 25, 7 L. Ed. 37.

Agency arises only by contract, says plaintiff in error. It may also exist by operation of law. Elliott on Contracts, Secs. 2831-2; Mechem on Agency, Sec. 1; *State* vs. *Hubbard*, 58 Kans. 797, 39 L. R. A. 860; *Sterna-*

man v. *Metropolitan Life Ins. Co.*, 170 N. Y. 13, 62 N. E. 763, 57 L. R. A. 318, 88 Am. St. 625.

It will thus be seen that under all the authorities, following either the so-called Massachusetts or forwarding agent rule or the New York or independent contractor rule, where the first bank is authorized by law or contract to transmit to a sub-agent for collection, such sub-agent thereby becomes the agent for and responsible to the depositor or holder. When the plaintiff in error undertook the collection of the Balfour check it became the agent of and was accountable to Malloy Brothers, and it makes no difference through how many intermediate banks the check passed.

The Florida statute and the deposit slip made the Perry Banking Company a forwarding agent only for the collection of the check, and its duty was performed when the check was forwarded to the Atlantic National Bank of Jacksonville.

This principle appears to be conceded in the brief for plaintiff in error, which states at the bottom of page 15: "All courts seem to be agreed that if there was an express contract defining the relationship and liability of the bank to its depositor, the terms of this contract would control."

Both parties are in agreement that the Massachusetts rule prevails in this case. The plaintiff in error says it is because of Regulation J. of the Federal Reserve Board; the defendants in error, because of the Florida statute and the deposit slip. It was established by *First Nat. Bank* v. *Planter's, &c.*, 75 N. C. 534, and *Bank of Rocky Mount* v. *Floyd*, 142 N. C. 163, that the Massachusetts rule prevails also in North Carolina.

The contract was made in Florida for the collection of the check in North Carolina, payment to be made defendants in error in Florida. So the Georgia statute has no application. *Kent* v. *Dawson Bank*, 13 Blatchf. 237; *St. Nicholas Bank* v. *State Natl. Bank*, 128 N. Y. 26, 13 L. R. A. 241, 27 N. E. 845.

For these reasons the authorities cited by plaintiff in error do not apply; and it will be noted that in *First Natl. Bank* v. *Federal Reserve Bank of Kansas City*, 283 Fed. 700, cited by appellant, it was the bank of deposit, as assignee of the depositors, suing the collecting bank, and it was held that it had no cause of action under the independent contractor principle, and also that it had not alleged the payment of any money or that it suffered loss.

Under the authority of this last case, the Citizens and Southern Bank of Atlanta, could not maintain this action against the plaintiff in error. Under the Florida act the Perry Banking Company could not do so either. It charged the check back to Malloy Brothers. (Record, middle p. 32.)

THE FEDERAL RESERVE BANK OF RICHMOND WAS NEGLIGENT IN SENDING THE CHECK DIRECT TO THE BANK OF LUMBER BRIDGE, NOTWITHSTANDING THE REGULATIONS OF THE FEDERAL RESERVE BOARD.

While the learned judge of the District Court held that under the Federal Reserve Act and the Regulation of the Federal Reserve Board plaintiff in error was authorized to send the check in suit direct to the Bank of Lumber Bridge, we do not concede the existence of such authority in so far as it binds Malloy Brothers.

The Federal Reserve Board Intended Regulation J for Member Banks and Not Innocent Depositors.

Attention is directed to the 11th section of the Federal Reserve Act prescribing the powers and duties of the Federal Reserve Board. The authority to promulgate regulation J is in no way conferred therein unless it be by Section j, which is: "To exercise general super-

vision over the said Federal Reserve Banks." Section 16, dealing with note issues, provides: "The Federal Reserve Board shall make and promulgate from time to time regulations governing the transfer of funds and charges therefor among the Federal Banks and their branches, and may at its discretion exercise the functions of a clearing house for such Federal Reserve Banks, or may designate a Federal Reserve Bank to exercise such functions, and may also require each such bank to exercise the functions of a clearing house for its member banks.

We respectfully submit that Regulation J of the Federal Reserve Board (p. 36) is a promulgation of rules governing the operation of Federal Reserve Banks while performing the functions of a clearing house, and that Malloy Brothers are not bound thereby, certainly not when they were ignorant of the existence of such rules. Malloy testified: "I know very little about the workings of a bank" (p. 32).

Clearing House Rules Are Not Binding on Malloy Brothers.

The banks which comprise a clearing association may enact such rules for the regulation of clearing house transactions as they deem proper. While these rules are binding upon the members of the association they are not, as a general rule, permitted to have any effect upon the rights of outsiders, such as depositors and other customers of the banks. Clearing house rules are not binding on such parties, nor have they the right to claim any benefit under them, unless they contract with reference to the rules. Brady on Bank Checks, Sec. 229, citing *People* v. *St. Nicholas*, 77 Hun. (N. Y.) 159, 28 N. Y. Supp. 407; *Nat. Union Bank* v. *Earle*, 93 Fed. 330; *Merchants Nat. Bank* v. *National Bank*, 139 Mass. 513, 2 N. E. 89; *Overman* v. *Hoboken City Bank*, 30 N. J. Law 61; *Louisiana Ice Co.* v. *State Nat. Bank*, McGloin (La.) 181.

See also *Dorchester* v. *Merchants Nat. Bank* (Tex.), 163 S. W. 5.

Plaintiff in error makes the point that it could not have received the check from Malloy Brothers direct. If this be true then defendants in error cannot be bound by the regulations of the Board which were not intended for them but only for the banks, and appellant cannot set up its own wrong as a defense.

It will be noted (Record, p. 41) that the depositions of J. E. Wallace and M. W. Bell were read in evidence over the objection of the defendants in error. Malloy's evidence (Record, p. 32) shows that he was ignorant of any contract or agreement between the banks handling this check. We also contended there was not sufficient proof of the contract alleged between the Federal Reserve Bank of Atlanta and the Citizens and Southern Bank of Atlanta, which was alleged to have been in writing and which was not shown to have been lost. It was likewise contended that the alleged contract between the Citizens and Southern Bank of Atlanta and the Atlantic National Bank of Jacksonville was not properly proven (Record, pp. 44 and 46). It is also in evidence (Record, pages 46 and 47) that there was no written agreement between the Federal Reserve Bank of Atlanta and the Citizens and Southern Bank of Atlanta by which the latter agreed in sending items direct to the Federal Reserve Bank of Richmond to be bound by any contract between the Federal Reserve Banks of Atlanta and of Richmond with reference to such items. Plaintiff in error attempted to show that the Citizens and Southern Bank of Atlanta was bound by Circular G-133, stating the terms and conditions upon which the Federal Reserve Bank of Atlanta would accept checks for collection, after its failure of proof that it had been furnished one of the circulars, by offering the testimony of the cashier of the Federal Reserve Bank of Atlanta to the effect that the Atlanta bank was a branch of the Citizens and Southern Bank of Savannah to which copies of the

circular were mailed. Malloy Brothers contended that if such were the fact it could not be shown in this manner, and that even were it true the Federal Reserve Bank of Atlanta dealt with the Citizens and Southern Bank of Atlanta direct and as a separate entity, and that it has officers and directors of its own who controls its affairs. We mention these matters to show that even if the defendants in error were bound by these alleged agreements such agreements were not proved.

"Direct Sending" is Negligence.

In *Winchester Milling Co.* v. *Bank of Winchester*, (Tenn.) 118 S. W. 248, 18 L. R. A. N. S. 441, Neil J., in holding that a bank receiving a check for collection is negligent in sending it to the drawee although it is the only bank in the place where it is located, says on page 446 (L. R. A. N. S.), after citing cases from Alabama, Colorado, Illinois, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Pennsylvania, Tennessee, Texas, and Federal cases: "We have examined all of the foregoing cases, except the last, which is not accessible to us, and find that they fully sustain the text to which they are cited." The later cases are then cited, and he says: "It is unnecessary to quote further from authorities on this side of the question. The only authorities to the contrary that we have any knowledge of are cited in Note 81, page 506, 5 Cyc. Law and Proc., being certain New York cases and some English cases and the case of *Kershaw* v. *Ladd*, 34 Or. 375. * * * We do not think the case of *Kershaw* v. *Ladd* sustains the text." He also distinguishes several of the other cases cited in the brief of plaintiff in error.

See also 3 R. C. L., Sections 255-258, title Banks, pages 627-630, where these views are discussed as the majority and minority views and that it is only in those few jurisdictions that custom, if established, is permitted

as a defense, and that in the many States following the prevailing view such usage and custom will not justify negligence.

The annotator to the note in 27 L. R. A. (*Anderson v. Rodgers*, 53 Kan. 542), says at page 249: "The result of the American decisions is entire unanimity in holding that it is not proper to send a check by mail directly to the drawee for payment, except in New York state, where, as shown above, the decision to the contrary cites as authority two other cases which do not exactly decide the question."

PLAINTIFF IN ERROR HAD NO RIGHT TO ACCEPT THE EXCHANGE DRAFT, AS COLLECTING AGENT FOR DEFENDANTS IN ERROR.

"That the power of a collecting agent, by the general law, is limited to receiving for the debt of his principal that which the law declares to be a legal tender, or which is by common consent considered and treated as money, and passes as such at par, is established by all the authorities," says *Mr. Justice* Field, delivering the opinion in *Ward* v. *Smith*, 7 Wall. 447, 19 L. Ed., at page 210. See also long list of cases cited in note to case in 52 L. R. A. N. S., at page 652.

A collecting bank has no implied power to receive anything but money in payment. Usage will not justify the receipt of worthless checks in payment of collections. Elliott, Contracts, Sec. 1767.

It may be stated as the general rule that an agent for collection has not, unless specially authorized, the authority to receive payment in anything but cash. Upon elementary principles of agency, therefore, if such an agent does accept anything other than cash in payment he will be liable to his principal for any loss the latter may suffer, and this rule is applicable to banks acting

as collecting agents, and if such a bank surrenders the instrument in return for a check or other paper of the party upon whom it was drawn it does so at its own risk, and is liable, irrespective of negligence in the collection of the substituted paper, if that paper is not paid. 3 R. C. L., Title Banks, Sec. 245, page 616.

Custom cannot justify negligence. *Pinkney* v. *Kanawha Valley Bank*, 68 W. Va. 254, 32 L. R. A. N. S. 987, 69 S. E. 1012, Ann. Cas. 1912 B, 115; *Bank of Rocky Mount* v. *Floyd*, *supra*.

The acceptance by a bank, employed to collect commercial paper, of a check in payment, is at its own risk. *Bank* v. *Union Trust Co.*, 149 Ill. 343, 23 L. R. A. 611, 36 N. E. 1029.

Where a bank accepts for payment any paper for that which it is employed to collect, its liability, in case the paper so accepted is not paid and the original paper surrendered, is measured by the face value of the original paper. *Winchester Milling Co.* v. *Bank of Winchester*, *supra*; *Kirkman* v. *Bank of America*, 165 N. Y. 132, 80 A. S. R., 714, 58 N. E. 753.

This check called for nine thousand *dollars*. We can not conceive that regulation J intended it should be paid with a worthless draft instead. If such were the intent, then the effect is the impairment of the obligation of contracts, and congress did not intend to delegate such power to the Federal Reserve Board, we are confident. No State may do so; and Congress could not delegate this power if it desired. 6 R. C. L., page 164.

The obligation of a contract to pay money is to pay that which the law shall recognize as money when the payment is to be made. Legal Tender cases, 12 Wall. at 548, 20 L. Ed. at 311.

It will not be presumed that an agent had authority to accept a draft on a third person in payment of a debt due the principal. *Rogers* v. *Tiedeman*, 98 Ga. A. 811, 72 S. E. 285.

The Acceptance of the Draft Was in Violation of the North Carolina Law.

It can never be held that an authority to accept in payment cash in New York or Baltimore funds will extend to accepting in payment the bill of insolvent debtor, no matter upon whom it may be drawn; for the credit of a bill is not enhanced by the credit of the drawee until acceptance. *Goldsborough* v. *Turner*, 67 N. C., at 410.

An attorney can not compromise his client's case without special authority to do so, nor can he, without such authority, receive in payment of a debt due his client anything except the legal currency of the country, or bills which pass as money at their par value by the common consent of the community. *Moye* v. *Cogdell*, 69 N. C. at 95.

The Legislature of North Carolina, at the 1921 session, passed an act with reference to banks, it being Chapter 20, the sections material to this argument being as follows:

> Sec. 2: "That in order to prevent accumulation of unnecessary amounts of currency in the vaults of the banks and trust companies chartered by this state, all checks drawn on said banks and trust companies shall, unless specified on the face thereof, be payable at the option of the drawee bank, in exchange drawn on the reserve deposits of said drawee bank when any such check is presented by or through any Federal Reserve Bank, postoffice or express company, or any respective agents thereof."
>
> Sec. 5: "That no officer in this state shall protest for non-payment any check or checks drawn on any bank or trust company chartered by this State when payment is refused by the drawee bank solely on account of failure or refusal of the holder or owner thereof to pay exchange charges herein authorized; and there shall be no right of action, either in law or equity, against any bank or trust com-

> pany chartered by this State, for refusal to pay any such check when such action is based alone on the ground of refusal to pay exchange or collection charges herein authorized."

If the Bank of Lumber Bridge had the right in 1920 to pay the checks drawn on it by means of exchange drafts, then this act was wholly unnecessary, and we submit that the act is conclusive evidence that prior to its enactment in 1921 North Carolina recognized authority to make remittance in money only. Under this act the exchange provided for must be on the reserve deposits of the drawee bank and not on some bank where there are not sufficient funds, as in the case at bar.

This is the act that was passed on in *Farmers Bank of Monroe, N. C., et als.*, v. *Federal Reserve Bank of Richmond*, 67 L. Ed. 737, 43 S. C. R. 641, where it is said (L. Ed. at 742-3):

> "The purpose of the statute, as its title declares, was to promote the solvency of state banks. We should, in the absence of controlling decision of the highest court of the state to the contrary, construe the statute not as authorizing payment in a 'bad' draft, but as authorizing payment in such exchange drafts only as had customarily been used in remitting for checks. * * * Furthermore, the checks which the Federal Reserve Act declares reserve banks may receive for collection are limited to those 'payable on presentation.' The expression would seem to imply that the checks must be payable either in cash or in such funds as are deemed by the reserve bank to be an equivalent. A check payable at the option of the drawee by a draft on distant reserves would seem not to be within the limited class of checks referred to in the act."

If the Balfour check was such that the Richmond bank was authorized by the act of Congress to collect, then the conclusion seems irresistible that it deemed the draft equivalent to cash, and having made such election

it ought not to be permitted to pass its loss on to the depositors, who did not have the right of election. Furthermore, one of the defenses in this case is that believing it had power under the act and regulation to do so, it attempted to make an agreement with the Bank of Lumber Bridge for it to remit *daily* for checks sent the latter, "by a draft *or* shipment of currency at our expense (Hale, p. 60).

Section 74 of the Negotiable Instruments act, in force in Virginia, North Carolina and Florida, provides: "The instrument must be exhibited to the person from whom payment is demanded, and, when it is paid, must be delivered up to the party paying it." (Virginia laws of 1898, ch. 866; Florida laws of 1897, ch. 4524; North Carolina laws of 1899, ch. 733, now ch. 58 of the consolidated statutes of N. C.)

The Supreme Court of North Carolina has not construed the 1921 act of that state "as authorizing payment in a 'bad draft.'" Diligent search reveals no holding by that court that the instrument may be delivered up until it is paid, except at the peril of the collecting agent.

Acceptance of Exchange Draft Was in Violation of Regulation J.

As will be seen by Regulation J (Record, p. 36) the Federal Reserve Board states that each Federal Reserve Bank is authorized "to receive from any non-member bank or trust company, solely for the purposes of exchange or of collection, deposits of current funds in lawful money, National bank notes, Federal Reserve notes, checks and drafts payable upon presentation, or maturing notes and bills, *provided such non-member bank or trust company maintains with its Federal Reserve Bank a balance sufficient to offset the items in transit held for its account* by the Federal Reserve Bank." (Italics ours.)

Section 13 of the Federal Reserve Act provides that "any Federal Reserve Bank * * * solely for the purposes of exchange or of collection, may receive from any non-member bank or trust company deposits of current funds in lawful money * * * checks and drafts payable upon presentation * * * provided such non-member bank or trust company maintains with the Federal Reserve Bank of its district a balance sufficient to offset items in transit held for its account by the Federal Reserve Bank."

Thus it will be seen that Section 8 of the Regulation (Record, p. 39) authorizing Federal Reserve Banks to send checks for collection to banks on which checks are drawn, is only in cases where the bank transmitting checks for collection maintains the required balance, to save the collecting bank free from loss resulting *from or for* the account of the other Reserve Bank so forwarding the items to the collecting bank. In other words, the Federal Reserve Board realizing the danger of direct sending requires indemnity against resulting loss.

While defendant was authorized to receive Balfour's check on Lumber Bridge for collection, there is no authority in either the act or the regulation for it to receive the exchange draft it accepted in payment from the Bank of Lumber Bridge, unless it maintained the required balance to offset the item.

The Federal Reserve Bank of Richmond is chargeable with knowledge of the Florida act, where the rights of Malloy Brothers became fixed when they deposited the check in the Perry (Fla.) bank. The Citizens and Southern Bank of Atlanta is likewise chargeable with knowledge of the status of the transaction under the Florida law—that the collecting bank became the agent of, and accountable to, the depositor. Malloy Brothers had no voice in the selection by the Atlanta bank of the collecting agent.

In both Georgia and Virginia the presumption is that the check is deposited for collection and that title does not pass to the bank, unless it was so intended.

When a check is deposited in the usual course of business it is taken generally for collection, and the title does not pass to the bank. *Baldwin State Bank* v. *National Bank*, 144 Ga. 181, 86 S. E. 538.

Where a check on another bank is endorsed without restriction, deposited, and the amount credited to the depositor, the bank reserving the right to charge it back, if not paid, whether the bank becomes the owner of the check depends solely upon the intention of the parties, even though the depositor is permitted to draw against the deposit. *Miller* v. *Norton & Smith*, 114 Va. 609, 77 S. E. 452.

Plaintiff in error, therefore, could not treat the item as the property of the Atlanta bank. The check was charged back by the Perry bank to Malloy Brothers, and there is no evidence that the deposit had been checked against (p. 32).

CONCLUSION OF FIRST ASSIGNMENT OF ERROR.

As heretofore shown, most of the cases cited in appellant's brief are decisions holding that, in the absence of anything to the contrary, the bank of deposit undertook the collection as an independent contractor, and the reasoning does not apply in the case at bar where the Perry bank became a forwarding agent only and the Federal Reserve Bank of Richmond became the collecting agent of Malloy Brothers.

Doubtless realizing the unsoundness of the contention that Regulation J authorized the acceptance of a worthless draft, our opponent seeks to enlarge this regulation by adding to it words that might cover this case, as shown at page 17 of its brief, had drawee kept a balance with appellant to offset the item.

There is nothing in the record to show that the exchange draft had not been sent when Balfour's check was marked "paid" on December 14th, nor that the Bank of Lumber Bridge was insolvent on that day. Had

it been, we think this would only add weight to the liability of the collecting agent for accepting the exchange draft.

There is no contention that appellant was a *bona fide* holder for value and without notice of the check in question. Authorities heretofore cited show the presumption was that its predecessors acquired the check for collection only and the Richmond bank had the right to and did charge back the item to the Citizens and Southern Bank.

The alleged agreement between the Richmond and Lumber Bridge banks required the latter to remit *daily* for checks it accepted. Remittance therefor should have been made on December 11th. Yet plaintiff in error waited until the 15th to receive a worthless draft and further indulged the Bank of Lumber Bridge—to see what explanation it had to make—until the 21st. Had compliance with the alleged agreement been insisted upon Malloy Brothers could have learned of the situation more than a week earlier than they did. Due diligence would have afforded defendants in error an opportunity to have gotten their money out of the $16,810 the District Court found (page 28) that the Lumber Bridge bank had on hand. After making them moneyless it ill becomes the appellant to say their effort would have been fruitless. Shall this indulgence be at the expense of Malloy Brothers, innocent parties in this transaction?

SECOND ASSIGNMENT OF ERROR.

This finding is: "There is no evidence of any custom existing either in Virginia or North Carolina, by which collecting banks are *authorized* to accept from their agents or subagents, or from the drawee banks in settlement of collections sent them, anything other than money in settlement of such collection," etc., (pp. 27 and 28, Assignment, pp. 73 and 85). The effect of such finding is, of course, that there is no evidence of an author-

ized custom. There is a further finding that appellees knew nothing of the usage or custom of banks in collecting checks delivered to them for collection or knew anything concerning the previous methods of dealing between the Federal Reserve Banks of Richmond and of Atlanta and the Citizens and Southern Bank (p. 70). Mr. Wallace's testimony was found insufficient to support a finding that there was any authorized custom to this effect. This finding that the collecting agent had no right to accept from the drawee bank anything except money for the Balfour check is fully sustained by a wealth of the best considered cases and text writers in this country, as heretofore shown; and it makes no difference whether the banks are located in the same town or not.

Appellant states in its brief, page 18, that Mr. Wallace's testimony was not offered to prove that the Federal Reserve Banks were authorized to send checks direct to the banks on which they were drawn, but only to show the intent and meaning of the regulations of the Federal Reserve Board, so it seeks to justify the direct sending not by reason of banking customs but because of Regulation J only; and as heretofore pointed out, it was not justified in so doing by the regulations of the Federal Reserve Board.

THIRD ASSIGNMENT OF ERROR.

We agree with appellant's counsel that this assignment is merely formal and that repetition is useless.

CONCLUSION.

We submit that it is established:

1. That when plaintiff in error accepted the check for collection it became the sub-agent of and was accountable to appellees.

2. That appellant was negligent in *surrendering* the check to the drawee bank.

3. That it was negligent in accepting the drawee's exchange draft in payment, and that it thereby made the paper its own.

4. That the regulations of the Federal Reserve Board do not justify but condemn this course of dealing.

5. That the Federal Reserve Bank of Richmond failed to use due diligence in waiting an unreasonable length of time on the Bank of Lumber Bridge, after mailing the check to it, and also before giving notice after learning of the protest of the draft.

Public confidence in banks is the greatest assets of these guardians of the country's savings. Had there been a suspicion that such deposit would result in the absolute surrender of the check to the drawee without obtaining the money therefor by a Federal Reserve Bank or any other bank, and that it could escape all liability, would the deposit have been made? What would be the use of a party placing his check in the hands of a bank for collection when that duty could be performed by merely endorsing the paper and sending it by mail to the party who is obligated to pay it, and receive his check in return? The plaintiffs could have sent the check direct to the Bank of Lumber Bridge and received another check in return several days before the Balfour check ever reached the appellant.

When it is remembered that the transaction was during a time of financial depression, particularly acute in the cotton producing sections; that plaintiff in error well knew that it was not unusual for remittance drafts by small banks to be dishonored; and that Malloy Broth-

ers were without laches and without knowledge of the alleged banking agreements and customs, then these innocent parties ought not to bear the loss, and the judgment should be affirmed.

Respectfully submitted, this 19th day of December, 1923.

ROBERT H. DYE,
Fayetteville, N. C.,
Counsel for Defendants in Error.

Supreme Court of the United States

OCTOBER TERM, 1923.

No. 553.

FEDERAL RESERVE BANK OF RICHMOND,
PLAINTIFF IN ERROR,

versus

D. J. MALLOY & J. H. MALLOY, TRADING AS MALLOY BROTHERS, DEFENDANTS IN ERROR.

IN ERROR TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

M. G. WALLACE,
Counsel for Plaintiff in Error.

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Supreme Court of the United States

FEDERAL RESERVE BANK OF RICHMOND,
PLAINTIFF IN ERROR,

versus

D. J. MALLOY AND J. H. MALLOY, PARTNERS, TRADING AS MALLOY BROTHERS,
DEFENDANTS IN ERROR.

REPLY BRIEF FOR FEDERAL RESERVE BANK OF RICHMOND, PLAINTIFF IN ERROR.

ANSWER TO THE CONTENTION THAT THE FEDERAL RESERVE BANK OF RICHMOND WAS THE AGENT OF MALLOY BROTHERS.

(Brief for Defendants in Error, pp. 6-9.)

In our brief we cited certain Federal cases holding hat when a check is routed for collection through sev- ral banks each successive bank may be sued only by its mmediate predecessor. We concede that there is an rreconcilable conflict of authority upon this point. We ubmit, however, that the rule which limits the right of ction to the immediate predecessor is the wiser and bet- er rule, for if a remote party may sue a bank which has eceived a check from another bank and may repudiate

all notice of previous dealings and also special contracts between the two banks which dealt directly with each other, it is obvious that no bank may safely accept a check from another bank for collection, for no matter what agreement or understanding it may have with the bank from which the check was received, there will always be danger that some remote party will attempt to bring an action, contending that such party is in no way bound by the contract or understanding, in pursuance of which alone the check was accepted for collection.

However, we wish to call especial attention to the fact that under the authorities cited by our opponents, and under any rule which might be adopted, if the Federal Reserve Bank of Richmond is to be deemed a subagent of Malloy Brothers, it must be likewise held that the Federal Reserve Bank of Atlanta and the Citizens & Southern Bank were agents for Malloy Brothers, and, being agents, entrusted with a check endorsed in blank and held out to the world as having full power to make arrangements for its collection, being to all appearances, in fact, owners of the check, any contract or understanding made by the Citizens & Southern Bank is necessarily binding upon Malloy Brothers, the remote principal. Our opponents seem to attempt to occupy two inconsistent positions. They contend that the Federal Reserve Bank is the agent of Malloy Brothers, but likewise contend that this agency arose by mere fiat of law and that the Citizens & Southern Bank was in no sense of the word an agent for Malloy Brothers. We respectfully submit that to establish one of these contentions would be to absolutely defeat the other. Each successive bank must have been the agent of Malloy Brothers, or else no bank, save the Perry Banking Company, can be deemed the agent of Malloy Brothers.

If the Citizens & Southern Bank was not the agent of Malloy Bros., then they have no right of action. If

the Citizens & Southern Bank was the agent of Malloy Bros. and, as such agent, appointed the Federal Reserve Bank of Richmond as a sub-agent, Malloy Bros. are bound by the terms of the appointment, and in ascertaining the terms of this appointment all agreements between the Federal Reserve Banks and the Citizens & Southern Bank are binding upon Malloy Bros., and all knowledge possessed by the Citizens & Southern Bank is imputable to Malloy Bros.

Our opponents appear to attempt to avoid this dilemma by the contention that the agency of the Federal Reserve Bank originated by more fiat of law and did not arise out of the contracts made between it and the Citizens & Southern Bank and the Federal Reserve Bank of Atlanta.

We will not attempt to enter upon a philosophical discussion as to whether or not a relation which arises by fiat of law may be ever aptly termed an agency. We concede that the term "agency" has been, by some courts and some text writers, applied to relationships which arise out of quasi contracts and that quasi contracts are, of course, obligations which have some resemblance to true contracts, but which do not arise from the voluntary assent of the parties. An examination of the authorities cited upon this point by our opponents will show that they can have no application to the present case.

It was decided by this court in *American Bank & Trust Company* v. *Federal Reserve Bank of Atlanta*, October Term, 1922, opinion delivered June 11, 1923, and in *Farmers & Merchants Bank* v. *Federal Reserve Bank of Richmond*, October Term, 1922, opinion delivered June 11, 1923, 43 Supreme Court Reporter 641, that a Federal reserve bank is under no obligation to accept a check payable by a non-member bank. The Bank of Lumber Bridge was a non-member bank. The Federal Reserve Bank of Richmond was, therefore, not bound to accept checks drawn upon it.

When the check in suit was tendered to the Federal Reserve Bank, it had the right to accept it for collection or to refuse to handle it. If it did accept the check for collection, its act in accepting it created an express or actual contract, and we have simply to discover the terms and conditions of the contract.

It is elementary that in order to interpret contracts we must look first to the express intent of the parties. If the intent is not completely expressed, we must look to the inferences which may be drawn from their acts, and in drawing these inferences we must consider the usual customs prevailing between other parties in similar situations, and we must look to the law of the State in which the contract was made, as determining all questions relating to the interpretation and validity of the contract, and to the law of the place in which the contract is to be performed as determining all questions relating to the performance. In this case, the Federal Reserve Bank of Richmond received the check merely as the deputy or substitute of the Federal Reserve Bank of Atlanta. It received it in virtue of an agreement between the Citizens & Southern Bank of Atlanta and the Federal Reserve Bank of Atlanta, both of which were in the State of Georgia. The contract was to be performed in the State of North Carolina. We respectfully submit that, regardless of whether or not the contract was in writing or inferred from previous dealings, or from the actions of the parties, it was a contract made in Georgia and to be performed in North Carolina. The law of Florida cannot enter into its interpretation or application.

ANSWER TO THE PLAINTIFF'S CONTENTION THAT THE FEDERAL RESERVE BANK OF RICHMOND WAS NEGLIGENT IN SENDING THE CHECK DIRECT TO THE BANK OF LUMBER BRIDGE, NOTWITHSTANDING THE REGULATIONS OF THE FEDERAL RESERVE BOARD.

(Brief for Defendants in Error, pp. 9-13.)

Under this head the defendants in error appear to take the position that the learned judge of the district court rendered the right judgment but based his decision upon erroneous reasons.

The learned judge below held, and, we believe, held correctly, that Regulation J stated completely the terms and conditions upon which the Federal reserve banks could receive checks for collection and were, therefore, binding upon all persons. The Federal Reserve Board is given power to regulate the charges made by Federal reserve banks for collecting checks. Federal Reserve Act, Sec. 16. It is obvious that the degree of responsibility and the methods employed in collecting must, to a large extent, determine the charge which is made for the service of collecting. Hence, the Federal Reserve Board, in regulating the Federal reserve bank and in fixing the charges which it may make when it receives checks for collection, must have, and under the portion of the Federal Reserve Act quoted in our opponents' brief has, power to prescribe uniform rules of liability, and all persons who deal with Federal reserve banks must take notice of the uniform terms and conditions of liability.

By a similar line of reasoning, this court, in the case of *Union Telegraph Co. v. Esteve*, 256 U. S. 566, 41 Sup. Ct. Rep. 587, held that the limitations upon the liability of a telegraph company which entered into and formed

a part of its tariff bound all persons, even though such persons did not know and could not know of the existence of the limitations. The court says: "Uniformity demands that the rate represent the whole duty and liability of the company. It could not be varied by agreement; still less could it be valid by lack of agreement. Assent to the terms of the rate was rendered immaterial, because when the rate is used dissent is without effect."

It is not, however, necessary for the court to go as far in this case as the court went in the Esteve case cited *supra*, for, in this case, it is clear that the limitations of liability contained in Regulation J have been made the subject of an express contract between the Citizens & Southern Bank and the Federal Reserve Bank of Atlanta, although our opponents seek to contend that this contract was not clearly and definitely proven. It appears from the testimony of M. W. Bell (Record, page 47) that Circular G-133, the pertinent portions of which are printed in the Record on page 44, was sent to the Citizens & Southern Bank, copies being sent to the main office in Savannah and, for convenience, also sent to the branch office in Atlanta. It is true that J. E. Wallace, Assistant Cashier of the Citizens & Southern Bank, stationed at its Atlanta office, testified (Record, page 45) that he did not recall having signed any copy of this circular, but he thought a copy was received and he stated that he was familiar in a general way with the collection system of the Federal Reserve Bank of Atlanta. If affirmatively appeared, however, that the circular was received at the home office in Savannah and receipt thereof was acknowledged, W. B. Spann, Jr., Assistant Cashier, signing the acknowledgment and formally agreeing, on behalf of his bank, to be bound by the terms and conditions in the circular. (See Record, page 47.)

Our opponents seem to take the position that a contract signed by an officer at the home office is not binding in dealings with branches, but we have always considered

that it was elementary that a corporation was but one person and that a contract made by one of its duly authorized officers, having general supervision of its business, bound the corporation as a whole, and, therefore, covered all dealings, no matter whether they originated with the home office or a branch. This elementary rule of general law appears to have been declared by statute in Georgia. Act of General Assembly of Georgia, No. 105, Session of 1919, Article 1, Section 3 (see Georgia Laws of 1919, page 136), is as follows (Italics ours):

> "*Branch banks.* Banks whose capital has been fully paid in, and is unimpaired, may establish branches in the cities in which they are located or elsewhere, after having first obtained the written approval of the Superintendent of Banks, which approval may be given or withheld by the Superintendent in his discretion, and shall not be given until he shall have ascertained to his satisfaction that the public convenience and advantage will be promoted by the opening of such branch.
>
> "Such branch banks shall be operated as branches and under the name of the parent bank, and *under the control and direction of the Board of Directors and executive officers of* said parent bank.
>
> "*The Board of Directors of the parent bank shall* elect a cashier, and such other officers as may be required to properly conduct the business of said branch, and a Board of Directors, or loan committee, who shall be responsible for the conduct and management of said branch, but not of the parent bank or any other bank, save that of which they are officers, directors, or committee."

It will appear from the above quoted provision that by the statute of Georgia officers at the home office have general supervision of all branches. We believe that this provision is in accord with usual corporate practice. The actions of Mr. Spann show clearly that he knew that when he signed the circular and agreed to its terms, it

lay with him to bring home notice of this contract to all of the branches, for he wrote (see Record, page 48) to the Federal Reserve Bank of Atlanta, requesting additional copies, stating that he intended to distribute them among the departments requiring the information.

THE GEORGIA STATUTE.

If, however, we assume that Regulation J is of no force or effect, and that the circular received and acknowledged by the Citizens & Southern Bank is likewise of no effect, we will then have it that the check in question was forwarded to the Federal Reserve Bank of Richmond for collection for the credit of the Federal Reserve Bank of Atlanta, just as if it had been by the Citizens & Southern Bank deposited in the Federal Reserve Bank of Atlanta and by that bank sent to Richmond. If the Citizens & Southern Bank had sent its clerk to the counter of the Federal Reserve Bank of Atlanta and deposited the check for collection, and there had been no understanding or agreement concerning the liability and there had been no regulation of the Federal Reserve Board in force, the situation would have been simply that of any depositor who places a check for collection in his bank. He thereby makes a contract, indefinite in its terms, but which, like any other contract, is to be ascertained by the *lex loci contractus* and the *lex loci solutionis*. (See *Scudder* v. *Union National Bank*, 91 U. S. 406.) This contract was made in Georgia and, from its nature, could be performed only in North Carolina. At the time that the contract was made, there was in force in Georgia a statute defining the liability of any bank *doing business within that State*. Section 36 of Article 19 of the Georgia Laws for 1919 is as follows:

"Forwarding Check Direct to Payer.—Any

bank, or banker, doing business in this State, receiving for collection or deposit, any check, note or other negotiable instrument drawn upon or payable at any other bank, located in another city or town, whether within or without this State, may forward such instrument for collection directly to the bank on which it is made payable, and such method of forwarding direct to the payer shall be deemed due diligence, and the failure of such payer bank, because of its insolvency, or other default, to account for the proceeds thereof, shall not render the forwarding bank liable therefor; provided, however, such forwarding bank shall have used due diligence in other respects in connection with the collection of such instrument."

It seems to us that it is plain that the Federal Reserve Bank of Atlanta must be deemed a bank doing business in the State of Georgia. It made in Georgia a contract for the collection of a check payable in North Carolina. The extent of its authority as agent and the methods which it might safely adopt in collecting the check are to be determined, in the absence of express agreement, by the statute of Georgia declaring the powers and liabilities of a collecting agent in such cases. The statute plainly provided that the check might be sent directly to the bank on which it is made payable and that such method of collecting should be deemed due diligence and that the forwarding bank should not be liable because of the insolvency or other default of the drawee. Since the Federal Reserve Bank of Atlanta might have sent the check directly to the Bank of Lumber Bridge, it might, of course, send it to the Bank of Lumber Bridge through the Federal Reserve Bank of Richmond, without incurring any liability because of the insolvency or other default of the Bank of Lumber Bridge.

While we think that the Georgia statute, rather than the laws of North Carolina, should be applied to the questions in this case, if the court should be of a different

opinion we call attention to the fact that there is in force in North Carolina a statute substantially similar to that in force in Georgia. Section 233 of the Consolidated Statutes of North Carolina reads as follows:

> "Collections Forwarded to Payer Bank.—Any banking corporation or banking and trust company, doing a fiduciary buisness, hereinafter called the bank, doing business in this State, receiving for collection or deposit any check, note or other negotiable instrument drawn upon or payable at any other bank, located in another city or town whether within or without this State, may forward such instrument for collection directly to the bank on which it is drawn or at which it is made payable, and such method of forwarding direct to the payer shall be deemed due diligence; and the failure of such payer bank, because of its insolvency or other default, to account for the proceeds thereof, shall not render the forwarding bank liable therefor: Provided, such forwarding bank shall have used due diligence in other respects in connection with the collection of such instrument. The provisions of this section shall not apply where there is more than one bank in a town."

There was but one bank in the town of Lumber Bridge. A Federal corporation is to be considered as domiciled and resident in every State in which it actually conducts its business. (*Texas & P. Railroad* v. *Arnecutt*, 92 S. W. 57, *in re*: *Cushings Estate*, 87 N. Y., Supplement 795). It appeared that the Federal Reserve Bank of Richmond was actively engaged in collecting checks in North Carolina. (Record, page 60.)

We, therefore, respectfully submit that the Federal Reserve Bank of Richmond is a banking corporation doing business in the State of North Carolina, within the meaning of the above mentioned statute, if such statute is applicable.

We make no attempt to analyze or discuss the true

interpretation of the circular of the Federal Reserve Bank of Atlanta viewed as an express contract, or of the statute of Georgia, or of the statute of North Carolina. We call attention to the fact, however, that all of them establish a rule of liability substantially identical with that embodied in Regulation J. Consequently, all that we have said with respect to the interpretation of Regulation J applies also to the interpretation of the circular and the statutes.

We conclude upon this point that the right of Malloy Brothers, if any, arises out of the fact that they were privy to the contract for the collection of the check by and between the Federal Reserve Bank of Atlanta and the Citizens & Southern Bank. If Malloy Brothers may maintain any action at all, they must maintain it upon this contract, for if each successive bank handling the check became their agent, the Citizens & Southern Bank was their agent, and since it was an agent acting for undisclosed principals, if the principals sue upon the contract made by the agent they thereby ratify it *in toto* and become bound by it as fully and as effectually as if it had been made with them in the first instance. The principals, in other words, stand in the shoes of the agent, and merely as a matter of convenience in procedure the suit proceeds in the name of the principals. The action is determined as though it had been brought by the agent.

We think that the above fully answers all that our opponents can say upon their point that Regulation J applies only to dealings between Federal reserve banks with member banks and clearing member banks. All checks which a Federal reserve bank receives must, of necessity, be received from members banks, clearing member banks, or certain public officers and agents. It can make no difference whether the member bank or clearing member bank is the holder of the check or itself an agent. If the check be endorsed in blank, the bank collecting it is held out to the world as the holder and it

may, therefore, contract with reference to the check as though it were the holder. If the depositor or customer of the member bank or clearing member bank seeks to sue upon the contract which the member or clearing member bank has made, he must stand in its shoes.

ANSWER TO THE CONTENTION OF THE DEFENDANTS IN ERROR THAT THE PLAINTIFF IN ERROR HAD NO RIGHT TO ACCEPT EXCHANGE DRAFT AS COLLECTING AGENT FOR THE DEFENDANTS IN ERROR.

(Brief for Defendants in Error, pp. 13-15.)

In our brief, pages 12 to 24, we discussed at length the right of the Federal Reserve Bank to send this check to the drawee and to accept an exchange draft in payment. We will not repeat that discussion but will only add that we did not contend that a collecting bank may, without assuming responsibility, send checks directly to the drawee for remittance unless expressly authorized to do so. We concede that under the great weight of authority it has been repeatedly held that collecting banks may not send checks directly to the drawee unless expressly authorized to do so, but the development of the banking business has demonstrated that the dangers inherent in this practice, are less than the advantages which may be obtained from it and that banks usually do handle checks in this way. It was the plain object of Regulation J, and of the statute which we have quoted above, to sanction the modern practice and method of sending checks directly to the drawee bank for remittance and to relieve collecting banks of liability for losses resulting from this practice, thereby changing the rule which had been applied in such cases as *Bank of Rocky Mount* v. *Floyd*, 142 N. C. 187. We do not con-

tend that ordinarily a collecting agent should surrender a negotiable instrument before it is paid. We concede that the great weight of authority holds that if the agent does this he renders himself liable, but all authorities admit that the principal may authorize the agent to do so, and we contend that to authorize an agent situated in Richmond to send a check to the bank upon which it is drawn, which bank is in a city or town one hundred or one hundred and fifty miles distant, is by necessary implication to authorize the bank to surrender the check before payment is received, for there is no practical way by which a person in Richmond may send a check to the town of Lumber Bridge and yet retain control over it and refuse to surrender it until payment is received. We might, at this point, repeat that we have challenged our opponents to outline any method which the Federal Reserve Bank of Richmond could have pursued under which it could have sent this check to Lumber Bridge and prevented the bank of Lumber Bridge from cancelling it before the exchange draft sent in remittance could have been collected. Our opponents have suggested no method, and we respectfully submit that if a collecting bank must, at its peril, prevent a bank upon which a check is drawn from cancelling it before remittance is made, or must, at its peril, see to it that the remittance draft is good before accepting the check, the collecting bank cannot send the check to the bank upon which it is drawn without becoming absolutely responsible for all the defaults of the drawee bank. If such a construction be given to Regulation J and the statutes which we have quoted, they become meaningless, and it is not to be thought that the Legislature of Georgia, and the Legislature of North Carolina, and the Federal Reserve Bank Board have established a rule of liability which provides in effect, that a bank may do that which it is physically impossible for anyone to do.

ANSWER TO PLAINTIFF'S CONTENTION THAT THE ACCEPTANCE OF EXCHANGE DRAFT WAS IN VIOLATION OF REGULATION J.

(Brief for Defendant in Error, pp. 15-19.)

In this portion of their brief, the defendants in error appear to take the position that a Federal reserve bank should not accept for collection any check unless it was drawn upon a bank which maintained a balance in the hands of the Federal reserve bank. This question was elaborately argued in the case of *American Bank & Trust Co. et als.* v. *Federal Reserve Bank of Atlanta*, October Term, 1922, opinion delivered June 11, 1923, 43 Sup. Ct. Rep. 649. In that case the court held that a Federal reserve bank might receive for collection any check payable upon presentation. This necessarily meant checks upon three classes of banks: member banks, clearing member banks which maintain accounts in the hands of Federal reserve banks, and non-member banks which maintain no clearing accounts.

We, of course, do not contend that the regulations contemplated that the Federal reserve bank should accept a worthless exchange draft in settlement for checks received for collection, and we concede that if the Federal Reserve Bank knew that the exchange draft was worthless or was not drawn against an available balance, the draft should have been refused, but there is, of course, no practical way by which any person may ascertain whether or not a draft is good, or is drawn against a sufficient balance until it be presented. Therefore, when the remittance draft was received by the Federal Reserve Bank of Richmond, it could not tell whether it was good or not until it was presented. It was compelled, therefore, to accept the draft and present it in order to determine whether or not it was good. The Federal Reserve Bank of Richmond had been for some

time accepting drafts from the Bank of Lumber Bridge and these drafts had been uniformly good. (See testimony of Edward Waller, Jr., Record, page 59.) The acceptance of the draft could not, therefore, be called negligence, and, as we pointed out in our brief, the district court seemed to recognize this.

THE FEDERAL RESERVE BANK OF RICHMOND HANDLED THE CHECK AND THE REMITTANCE-DRAFT PROMPTLY AND DILIGENTLY.

In the courts below, counsel for the defendants in error vigorously contended that the facts in this case showed that the Federal Reserve Bank of Richmond had not been prompt and diligent in handling the check and exchange draft. The learned judge of the district court disposed of this contention by saying (Record, page 23):

> "This (the forwarding of the check) was done promptly. The check was mailed at Atlanta, December 8th, mailed by the defendant, Federal Reserve Bank, December 10th, 1920, and received by the Lumber Bridge Bank, December 11th, 1920, being Saturday.
>
> "The Lumber Bridge Bank was the only Bank in the town at Lumber Bridge. There is no suggestion that, at that time, it was not in good standing and credit, or that defendant, Federal Reserve Bank of Richmond, had any cause to question its solvency or manner of conducting its business. It had made a 'par collection' agreement with defendant Bank.
>
> "I am led to the conclusion that the defendant, Federal Reserve Bank of Richmond, was not negligent in sending the check to the Lumber Bridge Bank for collection, and that it acted in that respect, promptly and in accordance with the terms upon which it accepted and undertook to act as agent in collecting the check."

We think that this ruling of the trial judge has eliminated all questions of delay from this case, and our opponents seem inclined likewise to this conclusion, for they appear to make no independent argument upon the point; but, inasmuch as their brief contains several allusions to delay, we undertake to state briefly the manner in which the check was handled, in order that this court may see that the Federal Reserve Bank of Richmond handled the check and the remittance draft promptly and in accordance with the terms upon which it undertook to act as an agent in collecting the check.

The Balfour check was received in Richmond on December 10, 1920, and was forwarded to Lumber Bridge on that day. It was probably received on December 11th. That being a Saturday and usually a half-holiday in banking circles, the remittance could not have been received in Richmond before December 13th, and, since banks frequently fail to handle letters received by them on Saturday, laying them over until Monday, and since delays in the mail are not unusual, especially shortly before Christmas when the business of the post office is exceptionally heavy, there was no occasion for comment upon any delay before Tuesday, December 14th. The remittance draft was sent upon that day and received on December 15th. As we have stated above, there was every reason to think that this remittance draft was good, and it was immediately forwarded to the Atlantic Bank & Trust Company of Greensboro, North Carolina. It should have been received by them on the 16th. If they did not accept and pay the draft, they had until the close of the succeeding business day in which to give notice of its dishonor. The notice of dishonor was given to the Federal Reserve Bank of Richmond on December 17th. The Federal Reserve Bank of Richmond immediately notified the Bank of Lumber Bridge that the remittance draft was dishonored. It might be said at this point that a check for $9,000.00 is an exceptionally large

check for a bank the size of the Bank of Lumber Bridge, and small country banks operate upon very small reserves. Hence, it was not an alarming circumstance that this exchange draft should be dishonored on first presentation, as this might readily occur from a temporary depletion of reserves or some delay in the transfer of funds. Under date of December 17th, at 4:35 P. M., the Bank of Lumber Bridge wired that the matter was being adjusted. Surely it was not unreasonable to allow them twenty-four hours to cover their draft before advertising to the world that they had defaulted in payment.

Opposing counsel have apparently, in their opening statement, made a slight mistake in stating that the record does not show this wire from the Bank of Lumber Bridge, for it is to be found on page 54.

December 18th was Saturday; the 19th was Sunday. A special representative was sent by the Federal Reserve Bank to the Bank of Lumber Bridge and arrived there on Monday, December 20th. He demanded payment and he could not obtain it. On the 21st, the Federal Reserve Bank of Richmond notified the Citizens & Southern Bank that they could not obtain payment from the Bank of Lumber Bridge.

We respectfully submit that the Federal Reserve Bank of Richmond did all that a diligent man could do with his own interest at stake. Opposing counsel contend that when the Federal Reserve Bank of Richmond accepted the exchange draft the Bank of Lumber Bridge still had sufficient cash and available balances to have paid $9,000.00, but it is obvious that the Federal Reserve Bank of Richmond could not know that the draft which it held was not good until it was presented. When it was presented it could only go to the Bank of Lumber Bridge and demand payment of the sum represented by the dishonored draft. It did this and it could not get payment. After payment was thus refused, the Federal Reserve

Bank of Richmond could have done nothing except to have brought suit upon the dishonored draft, but this would only have resulted in the closing of the Bank of Lumber Bridge. The Bank of Lumber Bridge may have had other assets but the Federal Reserve Bank of Richmond could not reach these assets without suit. It is very obvious that no material change took place in the situation of any party after December 15th. Whatever rights then existed existed when this suit was brought, and, therefore, the liability of the Federal Reserve Bank of Richmond cannot have altered since that time. If it did not render itself liable by accepting the exchange draft, it cannot be liable now, for since then it has done nothing but make a diligent, but unsuccessful, effort to collect the exchange draft, and it could have done no more.

ANSWER TO PLAINTIFF'S DISCUSSION OF THE SECOND ASSIGNMENT OF ERROR.

As we stated in our original brief, the second assignment of error does not present a proposition separate from the first.

We did not attempt to prove that banks were usually *authorized* to send checks to the banks upon which they were drawn or that they were usually authorized to accept exchange drafts from the drawee, but we did attempt to prove, and we think we showed beyond doubt, and in fact it is generally known, that banks do follow this method in practice and that, consequently, the statutes and regulations and contracts to which we have referred must be read as applying to existing practices of banks. If these are so read, it clearly appears that authority to send a check directly to the drawee means authority to send it to the drawee for remittance in the usual way, which is by an exchange draft, transfer of money, or shipment of currency.

We desire, however, to again call attention to the fact that the Malloys' ignorance or knowledge of banking customs can have nothing to do with this case. It is clearly established by the decisions of this court and all courts that contracts are construed in the light of general and universal customs and that the ignorance of a party to a contract of the existence of a custom will in no way affect the case if it appears that the custom is general and universal, for he must be conclusively presumed to have knowledge of the ordinary ways and means by which business affairs are conducted. This rule of law has especial value in actions in which the right of action depends on negligence; for negligence is, by definition, failure to do that which is usually done by prudent men in similar situations. If a different rule were adopted, we would find that there would be one rule for the ignorant and another for the well informed. The law would set a premium upon ignorance. This principle has been clearly stated by this court in the case of *Fowler* v. *Brantly*, 14 Pet. 318, 10 L. Ed. 473 (Italics ours):

> "The known customs of the bank, and its ordinary modes of transacting business, including the prescribed forms of notes offered for discount, were matters of proof, and entered into the contract; and the parties to it must be understood as having governed themselves by such customs and modes of doing business; *and this, whether they had actual knowledge of them or not;* and it was especially the duty of all those dealing for the paper in question to ascertain them, if unknown. Such is the established doctrine of this court, as laid down in *Renner* v. *Bank of Columbia*, 9 Wheat. 581; *Mills* v. *Bank of the United States*, 11 Wheat. 431; and *Bank of Washington* v. *Triplett*, 1 Peters 32, 33."

We submit in conclusion in this case that there are but two propositions for the court to decide:

First. Can Malloy Brothers maintain this action? We have pointed out that under the weight of authority in the Federal courts they cannot, but if they can do so they can do so only upon the theory that each successive bank was their agent; that is to say, that the Citizens & Southern Bank was their agent, and they, therefore, stand in the shoes of the Citizens & Southern Bank in every respect.

The second question is to determine the nature of the obligation imposed upon the Federal Reserve Banks by their contract with the Citizens & Southern Bank. Regardless of whether we consider the transaction between them as governed by the regulation of the Federal Reserve Board, the circular of the Federal Reserve Bank of Atlanta, the statute of Georgia, or the statute of North Carolina, in every case the result is the same. The Federal Reserve Banks were agents only, authorized to send the check directly to the bank upon which it was drawn without being responsible for the default of this drawee bank, or, indeed, for anything except negligence. Authority to send the check to the bank on which it is drawn necessarily implies authority to accept a remittance draft, because this is the usual method of making settlement and because when a check is surrendered to the drawee and the drawee accepts it, the drawer is released, the drawee becomes a debtor to the holder, and the acceptance of the exchange draft from the drawee, who has become the principal debtor, is merely a usual and convenient means of securing payment from this drawee.

Respectfully submitted this 7th day of January, 1924.

M. G. WALLACE,
Counsel for plaintiff in error.